The Economist

MARCH 21ST–27TH 2009

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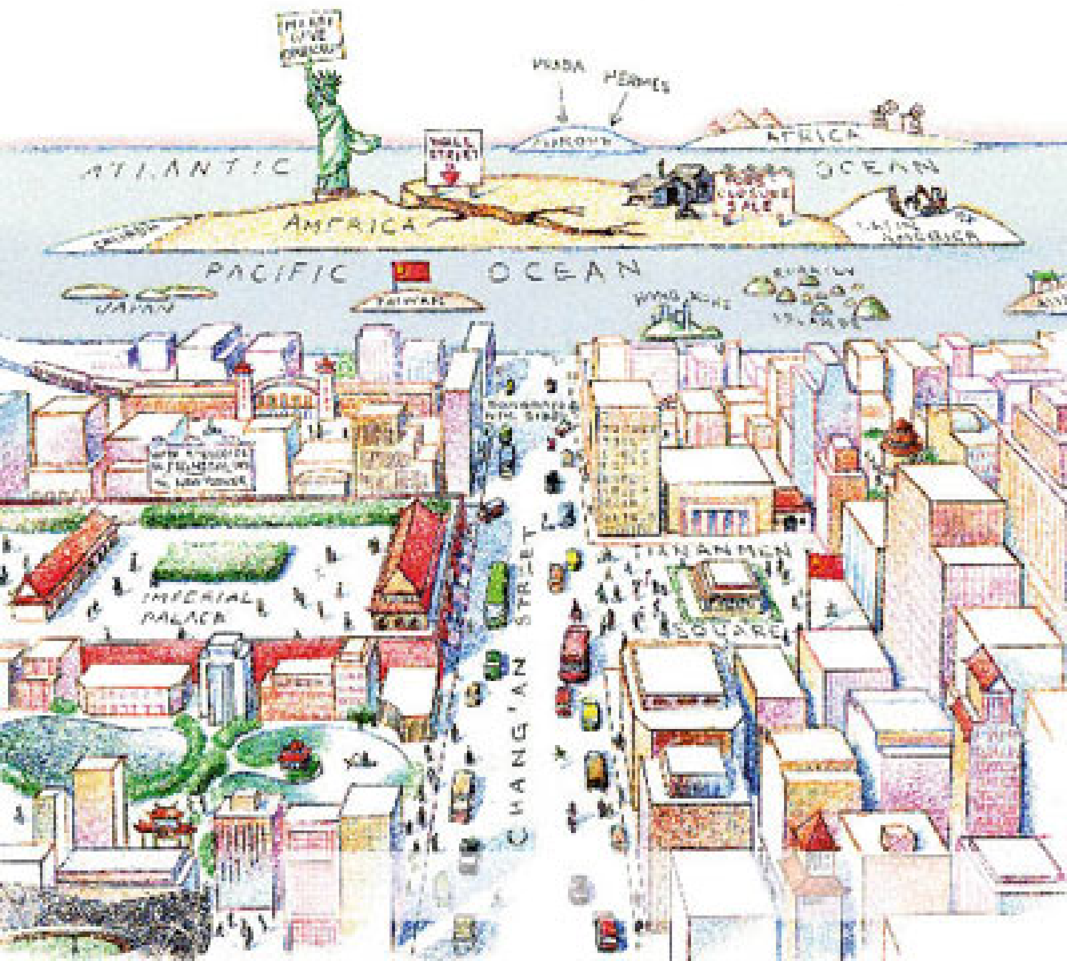
How China sees the world



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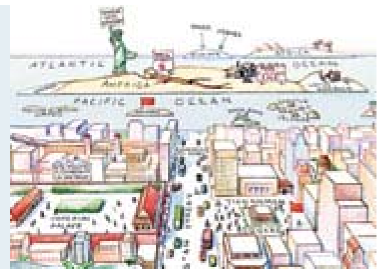
How China sees the world
And how the world should see China: leader



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Politics this week

Mar 19th 2009
From The Economist print edition

AFP

The government in **Pakistan** defused a mounting political crisis by announcing the reinstatement of Iftikhar Chaudhry as chief justice, a post from which he was sacked in 2007 by Pervez Musharraf, the president at the time. The issue had provoked huge protests. The reinstatement forestalled a procession to the capital, Islamabad, led by Nawaz Sharif, a former prime minister. See article

Pakistan's government dismissed a report in the *New York Times* suggesting that America was thinking about broadening the scope of its **unmanned air strikes** in Pakistan from the semi-autonomous tribal areas to include the province of Baluchistan. According to the report, the strikes, in support of operations in Afghanistan, had driven Taliban fighters out of the tribal areas.

The secretary-general of NATO, Jaap de Hoop Scheffer, said the alliance would send up to 4,000 additional troops to **Afghanistan** to improve security during the presidential election in August.

Karpal Singh, a leading opposition politician in **Malaysia**, was charged with sedition for an alleged insult directed at the sultan of Perak state. He said the charges were politically motivated. A day earlier, his son, also an opposition politician, was suspended from parliament for a year.

Campaigning began for parliamentary elections due to be held in **Indonesia** on April 9th. Parties must win at least 25% of the votes or 20% of the seats in parliament to be allowed to field candidates for the presidential election in August.

North Korean guards were reported to have detained two American journalists who were filming across the border from Chinese territory.

Remuneration rumble

A political row erupted over the payment of bonuses to executives of **American International Group**, a troubled insurer which has received $170 billion in taxpayers' money. President Obama called on his treasury secretary to find a way of rescinding the payments, and Congress said it might try to tax them away. See article

A Gallup poll showed that American **support for the war** in Afghanistan has hit a new low, with 42% of respondents saying that sending American troops to the country had been a mistake.

In the United States New Mexico abolished the **death penalty** after DNA evidence proved that innocent people had been executed in the past. It is the second state to do so since the Supreme Court restored state control over the punishment in 1976.

A fiercer bear

EPA

Russia's president, Dmitry Medvedev, announced a rearmament plan, promising to spend $140 billion on weapons during the next three years. Some analysts doubt whether Russia can afford such expenditure with oil prices now about $50 a barrel. See article

A second one-day strike hit **France**, with millions of workers taking to the streets to demand an end to job and pay cuts. The government vowed to make no more concessions. See article

France’s parliament supported President Nicolas Sarkozy’s decision to bring the country back into **NATO’s** military command, reversing a decision taken in 1966 by Charles de Gaulle.

The **Czech** government withdrew treaties on American missile defence from parliament, fearing a possible defeat. Missile defences will be discussed by the American and Russian presidents when they meet in London at the G20 summit early next month.

In the most publicised criminal case ever held in **Austria**, Josef Fritzl pleaded guilty to all charges relating to the imprisonment and rape of his daughter and the murder of one of the children he fathered by her.

Hostile takeover

After months of strife, Andry Rajoelina, the mayor of **Madagascar’s** capital, Antananarivo, ousted the president, Marc Ravalomanana, with the help of rebel soldiers. He promised to hold elections within two years. See article

A former reformist president of **Iran**, Muhammad Khatami, withdrew from the presidential election due in June. He is expected to back a reformist former prime minister, Mir Hosein Mousavi, against Mahmoud Ahmadinejad, the populist incumbent. See article

Israel’s departing prime minister, Ehud Olmert, failed to clinch a deal to free an Israeli sergeant, Gilad Shalit, who was captured by the Islamists of Hamas three years ago, in return for the release of 450 long-term Hamas prisoners, including some deemed responsible for planning suicide-bombings.

Muntadar al-Zaidi, an **Iraqi** journalist who hurled his shoes at George Bush during the American president’s press conference in Baghdad in December, as a protest against the American-led invasion of his country, was sentenced to three years in prison.

Truck off

AP

Mexico imposed tariffs of up to 45% on 90 products it imports from the United States, in retaliation for a provision, inspired by the Teamsters’ Union, in America’s omnibus appropriations law which scraps a pilot programme allowing some Mexican trucks to operate north of the border as the **North American Free-Trade Agreement** requires. See article

Venezuela’s president, Hugo Chávez, ordered the navy to take over the operation of ports as part of his drive to strip opposition state governors of their powers. He also invited Russia to use Venezuela’s military airports to refuel its strategic bomber aircraft.

Cristina Fernández de Kirchner, **Argentina’s** president, asked the country’s Congress to bring forward to June 28th a legislative election originally due in October. She cited the need for unity in the face of a gloomy economic situation—which opponents believe could lead to a heavy defeat for the government.

Another Central American country turned left. Mauricio Funes, an ex-journalist, ended two decades of conservative rule in **El Salvador**, winning the presidency for the FMLN, a party formed by ex-guerrillas. He promised “safe” social-democratic change. See article

A crowd of **shoe-throwing** demonstrators gathered outside a conference centre in Canada, as Mr Bush spoke to 1,500 businessmen in his first speech since stepping down as president.

Business this week

Mar 19th 2009
From The Economist print edition

The **Federal Reserve** said that it would buy up to $300 billion in long-term American treasury bonds and several hundred billions more in mortgage-backed securities in an attempt to see off the threat of deflation. The unanimous decision came at a meeting of the Fed's Open Market Committee on March 18th. See article

Turning the page

A report by the chairman of Britain's **Financial Services Authority**, Lord Turner, called for sweeping changes to the way in which the financial-services industry is regulated. The report recommended the setting up of an independent European regulatory body. It also proposed measures to curb institutions' ability to take excessive risks, including increases in the amount of capital that banks must hold, as well as limits on their gross leverage ratios. See article

The **Swiss National Bank** intervened in currency markets for the first time since 1992, selling Swiss francs and buying euros and dollars to weaken the currency, which then saw its biggest weekly decline against the euro since 1999. It has since appreciated slightly on news that Swiss retail sales continued to rise in January. See article

Nokia, the world's largest maker of mobile phones, said that it would cut up to 1,700 jobs, or about 1.3% of its total workforce. The company aims to trim costs by roughly $900m this year.

Lindt & Sprüngli, a Swiss chocolate maker, will close 50 of its 80 boutiques in America as sales growth slows. The company began to open these shops in 1994.

Ford's European division, hit by a fall in the demand for cars, has announced plans to cut production capacity in its plants in Germany, Spain and Romania. Working hours will be cut in the company's plant at Saarlouis in Germany, and a factory in Valencia, in Spain, will move to two shifts from three from May 1st.

Fizzling out

Coca-Cola's $2.3 billion bid for China Huiyuan Juice Group was rejected by the Chinese Ministry of Commerce, which cited concerns about competition in the country's market for soft drinks. Although Coca-Cola already has over half of that market, some see the decision as a sign of growing hostility to foreign investment in China. See article

Workers at a transmission plant belonging to **Magna International**, North America's largest car-parts maker, rejected an agreement that could have kept open the New Process Gear factory, which employs 1,400 people.

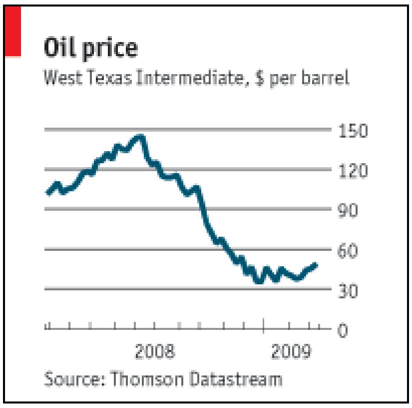
HCL Technologies, an Indian IT services company, signed a contract worth $350m with **Reader's Digest Association**. The deal is being seen as a shot in the arm for outsourcing in India, which has suffered from revelations of fraud in Satyam, one of the industry's largest companies.

Jan du Plessis, now the chairman of British American Tobacco, was named as the new chairman of **Rio Tinto**, a mining giant. The company is in the middle of protracted negotiations over selling a stake to Chinalco, a state-owned Chinese aluminium company.

Friends Provident, a British insurer, saw net losses of £541m ($1 billion) in 2008, more than five times its 2007 loss of £108m. The company has already cut 10% of its workforce in an effort to reduce costs.

After the fall

OPEC, which supplies about two-fifths of the world's oil, decided against further production cuts in a meeting in Vienna on March 15th. The oil producers have cut production three times since September in an attempt to arrest the fall in oil prices, which have fallen by about $100 a barrel, to below $50 a barrel, on the New York Mercantile Exchange since peaking last July. But OPEC members still have not cut production to levels agreed on in December. The International Energy Agency says that full compliance with the December cuts would reduce oil stocks in rich countries rapidly.



Trading down

The number of **premium air travellers** worldwide fell by 16.7% in the year to January, according to the International Air Transport Association. With an 18.9% increase, Africa was the only region to see premium traffic rise. Fares have fallen, too, with the sharpest declines being in Europe and the North Atlantic region. IATA reckons that revenue from premium passengers fell by 25% in the same period.

Serge Foucher, chief executive of **Sony France**, and Roland Bentz, its personnel manager, were freed on March 13th by workers who had prevented them from leaving a factory in south-west France the previous day because they were unhappy at their severance offer. Sony has said that it will cut about 8,000 jobs worldwide. See article

KAL's cartoon

Mar 19th 2009
From The Economist print edition

Illustration by KAL

The new world order

How China sees the world

Mar 19th 2009
From The Economist print edition

And how the world should see China

Illustration by Jon Berkley (with apologies to Steinberg and *The New Yorker*)

IT IS an ill wind that blows no one any good. For many in China even the buffeting by the gale that has hit the global economy has a bracing message. The rise of China over the past three decades has been astonishing. But it has lacked the one feature it needed fully to satisfy the ultranationalist fringe: an accompanying decline of the West. Now capitalism is in a funk in its heartlands. Europe and Japan, embroiled in the deepest post-war recession, are barely worth consideration as rivals. America, the superpower, has passed its peak. Although in public China's leaders eschew triumphalism, there is a sense in Beijing that the reassertion of the Middle Kingdom's global ascendancy is at hand (see article).

China's prime minister, Wen Jiabao, no longer sticks to the script that China is a humble player in world affairs that wants to focus on its own economic development. He talks of China as a "great power" and worries about America's profligate spending endangering his $1 trillion nest egg there. Incautious remarks by the new American treasury secretary about China manipulating its currency were dismissed as ridiculous; a duly penitent Hillary Clinton was welcomed in Beijing, but as an equal. This month saw an apparent attempt to engineer a low-level naval confrontation with an American spy ship in the South China Sea. Yet at least the Americans get noticed. Europe, that speck on the horizon, is ignored: an EU summit was cancelled and France is still blacklisted because Nicolas Sarkozy dared to meet the Dalai Lama.

Already a big idea has spread far beyond China: that geopolitics is now a bipolar affair, with America and China the only two that matter. Thus in London next month the real business will not be the G20 meeting but the "G2" summit between Presidents Barack Obama and Hu Jintao. This not only worries the Europeans, who, having got rid of George Bush's unipolar politics, have no wish to see it replaced by a Pacific duopoly, and the Japanese, who have long been paranoid about their rivals in Asia. It also seems to be having an effect in Washington, where Congress's fascination with America's nearest rival risks acquiring a protectionist edge.

Reds under the bed

Before panic spreads, it is worth noting that China's new assertiveness reflects weakness as well as strength. This remains a poor country facing, in Mr Wen's words, its most difficult year of the new

century. The latest wild guess at how many jobs have already been lost—20m—hints at the scale of the problem. The World Bank has cut its forecast for China's growth this year to 6.5%. That is robust compared with almost anywhere else, but to many Chinese, used to double-digit rates, it will feel like a recession. Already there are tens of thousands of protests each year: from those robbed of their land for development; from laid-off workers; from those suffering the side-effects of environmental despoliation. Even if China magically achieves its official 8% target, the grievances will worsen.

Far from oozing self-confidence, China is witnessing a fierce debate both about its economic system and the sort of great power it wants to be—and it is a debate the government does not like. This year the regime curtailed even the perfunctory annual meeting of its parliament, the National People's Congress (NPC), preferring to confine discussion to back-rooms and obscure internet forums. Liberals calling for greater openness are being dealt with in the time-honoured repressive fashion. But China's leaders also face rumblings of discontent from leftist nationalists, who see the downturn as a chance to halt market-oriented reforms at home, and for China to assert itself more stridently abroad. An angry China can veer into xenophobia, but not all the nationalist left's causes are so dangerous: one is for the better public services and social-safety net the country sorely needs.

So China is in a more precarious situation than many Westerners think. The world is not bipolar and may never become so. The EU, for all its faults, is the world's biggest economy. India's population will overtake China's. But that does not obscure the fact that China's relative power is plainly growing—and both the West and China itself need to adjust to this.

For Mr Obama, this means pulling off a difficult balancing act. In the longer term, if he has not managed to seduce China (and for that matter India and Brazil) more firmly into the liberal multilateral system by the time he leaves office, then historians may judge him a failure. In the short term he needs to hold China to its promises and to scold it for its lapses: Mrs Clinton should have taken it to task over Tibet and human rights when she was there. The Bush administration made much of the idea of welcoming China as a "responsible stakeholder" in the international system. The G20 is a chance to give China a bigger stake in global decision-making than was available in the small clubs of the G7 and G8. But it is also a chance for China to show it can exercise its new influence responsibly.

The bill for the great Chinese takeaway

China's record as a citizen of the world is strikingly threadbare. On a host of issues from Iran to Sudan, it has used its main geopolitical asset, its permanent seat on the United Nations Security Council, to obstruct progress, hiding behind the excuse that it does not want to intervene in other countries' affairs. That, sadly, will take time to change. But on the more immediate issue at hand, the world economy, there is room for action.

Over the past quarter-century no country has gained more from globalisation than China. Hundreds of millions of its people have been dragged out of subsistence into the middle class. China has been a grumpy taker in this process. It helped derail the latest round of world trade talks. The G20 meeting offers it a chance to show a change of heart. In particular, it is being asked to bolster the IMF's resources so that the fund can rescue crisis-hit countries in places like eastern Europe. Some in Beijing would prefer to ignore the IMF, since it might help ex-communist countries that have developed "an anti-China mentality". Rising above such cavilling and paying up would be a small step in itself. But it would be a sign that the Middle Kingdom has understood what it is to be a great power.

The pope in Africa

Sex and sensibility

Mar 19th 2009
From The Economist print edition

Doing harm in places where Catholicism should have a bright future

AFP

AFRICANS always give a visiting pope a hearty welcome. Thousands of finely dressed Cameroonians danced and sang at the roadside this week as Pope Benedict XVI arrived on an inaugural African tour that will also take in Angola. The Vatican is keen on the continent, home to around 135m Catholics. Pope Benedict delivered a compassionate message, recognising that Africa suffers disproportionately from food shortages, poverty, financial turmoil and a changing climate. Yet for all the mutual appreciation, he got one matter painfully wrong.

Asked about the use of condoms to help tackle the scourge of AIDS, the pope restated, in unusually explicit terms, the church's position that these are not useful to "overcome" the epidemic, indeed their use actually makes the problem worse. He suggested the disease could be beaten through chastity, abstinence and "correct behaviour". Speaking in a continent where more than 20m people have died from AIDS and another 22.5m are infected with HIV, his statement sounded otherworldly at best, and crass and uncaring at worst. Merely wishing away human sexual behaviour does nothing for the potential victims of AIDS, many of whom are innocent under even the most moralistic definition of that word.

Distributing more condoms would not, on its own, stop the spread of AIDS. Lots of measures are needed: improving education, encouraging monogamy, delaying the age of first sexual encounter, helping young women to win a greater say over their sex lives and widening access to antiretroviral drugs that lessen sufferers' infectiousness. Male circumcision seems to limit the disease's spread. But giving people condoms can be particularly useful. Experience in Thailand, which snuffed out a rapid early increase of HIV, suggests that condom use, especially by prostitutes and their clients, is effective. The World Health Organisation points out that condoms, used properly, cut the chance of HIV infection by 90%.

Clever leaders matter too. Uganda's president, Yoweri Museveni, talked frankly and often about "ABC" habits—abstain, be faithful, use condoms—and saw levels of infection in his country fall. Leaders who deny the science or seriousness of the epidemic, or who are too squeamish to talk of condoms and sex, leave people confused and at great risk: Harvard researchers last year estimated that the approach of South Africa's Thabo Mbeki had led to 330,000 needless deaths. Sadly, Pope Benedict has put himself squarely in the denial camp.

An ugly light

It need not be that way. Three years ago Pope Benedict was willing for his council for health to consider

whether condom use would be a “lesser evil” than allowing the spread of a deadly virus. Liberal cardinals had suggested that in a marriage where one partner is infected, condoms should be permitted. In Africa, as elsewhere, many Catholics simply ignore the Vatican’s view on condoms anyway.

The pope now seems immovable on the issue. His words on condoms and AIDS look particularly heartless in light of a scandal in Brazil that also casts the Catholic church in a poor light. An archbishop there excommunicated doctors for performing an abortion on a nine-year-old girl who had been raped repeatedly by her stepfather and made pregnant with twins. The girl’s mother was also expelled from the church; the rapist was not. The Vatican has made a partial retreat, criticising the haste with which the decision was made—and, eventually, the decision itself. In this and in its views on condom use to combat the spread of AIDS, the Vatican risks seeming callous to the plight of the weakest, surely those whom the church should strive hardest to protect.

AIG and the president

Easy does it

Mar 19th 2009
From The Economist print edition

Barack Obama needs to damp down the fury over bonuses, not add to it

AP


"RESIGN or go commit suicide." According to Charles Grassley, these are the only honourable choices open to the executives of American International Group (AIG) who have taken $220m in bonuses since the insurance giant was bailed out with $170 billion of taxpayers' money. When even Republican senators start advising businessmen to kill themselves, you know things have got nasty.

The row has been fanned by the media, delighted at last to have a simple story to tell about a financial crisis that is hideous in its complexity as well as its consequences, and stoked by politicians from the most junior representatives to the president himself. This week Barack Obama ordered his treasury secretary to find a legal way to claw back the bonuses (see article). The Democratic leadership in Congress suggested a special tax, set as high as 98%, to do it if that failed.

Revenge is pleasant, but dangerous

The instinct to punish such shameless greed is understandable. The financial crisis and its repercussions have been horribly unjust. A handful of people took staggering risks with America's largest financial institutions. The gambles went wrong, but they made out like bandits, and now the institutions they wrecked are being bailed out with public money.

Raging at bankers, however, is a dangerous road to tread. Banks and insurers are being bailed out not because they deserve it, or for the sake of their employees, but because there is no choice. America lacks an orderly system for winding down big financial institutions such as AIG; letting them fail would ultimately have been costlier than saving them, and the pain would have fallen on Main Street even more than on Wall Street. More broadly, demonising finance and bankers makes it politically harder to repair the financial system, which involves working with, and even rewarding, them. Some financiers now say they are reluctant to take part in government bail-out schemes, precisely because they fear retrospective vengeance in the future. That will slow the recovery.

Besides, it is not clear what Mr Obama can do about those AIG bonuses. Since it seems unlikely that there is a legal way to avoid paying them, his protest will merely have served to highlight his impotence. The same thing happened when the British government tried, and failed, to get the boss of the ruined Royal Bank of Scotland to surrender part of his pension.

Mr Obama has several other options, but none looks good. He could try to use executive power to break

the contracts; but that would tie him in legal knots and might undermine confidence in the rule of law. Investors are already fearful that nasty things could happen to some of the debt they hold, such as having it converted into stock against their will.

Alternatively, Mr Obama could seek to recoup the money, on behalf of taxpayers, by withholding an equivalent amount from the next tranche of bail-out money, some $30 billion, due to be paid to AIG. A moment's thought should show how foolish that would be. The bonuses would still remain in the pockets of the employees whose failures deserve censure, not reward. AIG itself would get less; but that would send the odd signal that the government had been prepared to give the company more than it really needed.

Or else Mr Obama can simply ventilate a bit, as he has done, but actually do nothing. That might seem harmless enough. But by revving up the outrage he will probably weaken his position with Congress. Getting money from the legislature has not been easy, even for the newly elected Mr Obama. He pushed his stimulus package through Congress by a wafer-thin margin; the Troubled Asset Relief Programme, money to be used for bailing out banks, was originally turned down by Congress. If Mr Obama now has to go back for either a second stimulus package or a new round of funding to buy toxic assets from the banks, he could face stouter opposition. Perhaps realising this, the president had rowed back a bit by mid-week.

Mr Obama's best course is to explain, calmly and patiently, why bailing out banks and honouring contracts are necessary evils. He needs to eschew easy gestures, just as he should have avoided delighting a few populists this week by closing down a scheme that lets Mexican trucks into America. It demands leadership, which he was elected to provide. In the past few weeks he has shown signs of forgetting that.

Economist.com OPINION LEADERS

Iran

The problem of Persian pride

Mar 19th 2009
From The Economist print edition

Iran is unlikely to respond to overtures from Barack Obama; but it’s worth a try

Reuters

THE Islamic Republic of Iran is nearing a moment of truth. In the next few months its leaders, nudged by its people at presidential polls in June, will have to decide whether to return to the comity of nations or stick to their angry, self-isolating revolutionary rhetoric. America, the revolutionaries’ Great Satan, is seeking to reopen a conversation after three decades of a dialogue of the deaf.

Looking for ways to end the stalemate, Barack Obama has commissioned a re-examination of policy on Iran. Hillary Clinton, Mr Obama’s secretary of state, in an early gesture of conciliation, has offered Iran a seat at a conference on Afghanistan that is to take place at the end of this month. All the signs are that, if America and others involved in the diplomatic effort to coax the mullahs into talks could find a way to overcome Iran’s continuing refusal to stop enriching uranium, Iran would be welcomed back as a recognised force in the region with a guaranteed role in any new security arrangement in the Gulf. That could make other problems easier to tackle.

But can it happen? Fathoming the intentions of the men in turbans who run Iran has long proved one of the hardest of diplomatic tasks (see article). It is a prickly country, proud of its history and wary of the other great peoples—Arabs, Turks and Russians—who ring it. America is all around it too: in Turkey, a vital member of NATO; in Iraq, where it still has more than 130,000 troops, despite a gradual drawdown; in Afghanistan, to which Mr Obama has promised to send another 17,000 soldiers to add to the 38,000 already there; and just across the Gulf in Bahrain, a statelet that Iran in its feistier moments claims as its own, where America anchors its Fifth Fleet. Most Iranians think that foreigners, especially Americans, Britons and Arabs, are still determined to do their country down.

The lure of the bomb

Persian pride thus dictates that if the regional likes of Pakistan, India and Israel can have nuclear power—and the bomb—then surely so should Iran, though it vehemently denies any intention to build nuclear weapons. Most of the rest of the world, led by the Americans and the other four permanent members of the UN Security Council, including China and Russia, disagree with differing levels of firmness. Three Security Council resolutions in recent years have imposed targeted sanctions on the Islamic Republic for refusing to stop enriching uranium, a potential bomb ingredient. Israel, in particular, is appalled by the prospect of Iran having the bomb.

The candidates now limbering up to fight for Iran’s presidency are a varied bunch. The most dialogue-minded of them, Muhammad Khatami, a former reformist president, has just dropped out of the race. He

may, however, now back a tougher reformist alternative in the person of Mir Hosein Mousavi, prime minister during Iran's war with Iraq in the 1980s. For his part, President Mahmoud Ahmadinejad, a belligerent, Holocaust-denying populist, is determined to stay put, with the Revolutionary Guard behind him. For now, he seems also to have the backing of Iran's supreme leader, Ayatollah Ali Khamenei, a cleric anointed by the late Ayatollah Khomeini, the founding father of a revolutionary theocratic Iran.

And there is the nub of Mr Obama's problem—and Iran's. It is Mr Khamenei, not the president, who ultimately calls the shots in foreign policy, including nuclear matters. A strict vetting system can block the candidacy in elections of anyone deemed too liberal or too secular. Mr Ahmadinejad has made a hash of the economy, so there is at least a chance he could be defeated at the polls by a more pragmatic figure. But all candidates will support continuing the nuclear programme. Even if a reformist won, he would not necessarily bring harmony to Iran's relations with America and the outside world.

Time, however, is running short. Israel's probable new government, if sufficiently alarmed, could decide to bomb Iran's nuclear facilities even without an American green light. Mr Obama will seek to persuade others, especially Russia, to tighten sanctions and thus strengthen his hand. Ideas for putting in place the conditions to get talks going include a time-limited suspension of uranium enrichment in return for freezing sanctions; removing stocks of low-enriched uranium (which, enriched further, could make a bomb) for fashioning into reactor fuel abroad; and setting up an international consortium to manage enrichment in Iran with UN monitoring (though this would help it hone its suspect nuclear skills).

Iran has much to gain by showing a readiness to limit its nuclear ambition. It may never do so, even at the risk of being bombed. So far it has shown little sign of flexibility towards Mr Obama. But he should still have one more try.

Internet companies

The end of the free lunch—again

Mar 19th 2009
From The Economist print edition

The demise of a popular but unsustainable business model now seems inevitable

Illustration by S. Kambayashi

"IN RECENT years, consumers have become used to feasting on online freebies of all sorts: news, share quotes, music, e-mail and even speedy internet access. These days, however, dotcoms are not making news with yet more free offerings, but with lay-offs—and with announcements that they are to start charging for their services." These words appeared in *The Economist* in April 2001, but they're just as applicable today. During the dotcom boom, the idea got about that there could be such a thing as a free lunch, or at least free internet services. Firms sprang up to offer content and services online, in the hope that they would eventually be able to "monetise" the resulting millions of "eyeballs" by selling advertising. Things did not work out that way, though, and the result was the dotcom crash. Companies tried other business models, such as charging customers for access, but very few succeeded in getting people to pay up.

Then it happened all over again, starting in 2004 with the listing of Google on the stockmarket, which inflated a new "Web 2.0" bubble. Google's ability to place small, targeted text advertisements next to internet-search results, and on other websites, meant that many of the business models thought to have been killed by the dotcom bust now rose from the grave. It seemed there was indeed money to be made from internet advertising, provided you could target it accurately—a problem that could be conveniently outsourced to Google. The only reason it had not worked the first time around, it was generally agreed, was a shortage of broadband connections. The pursuit of eyeballs began again, and a series of new internet stars emerged: MySpace, YouTube, Facebook and now Twitter. Each provided a free service in order to attract a large audience that would then—at some unspecified point in the future—attract large amounts of advertising revenue. It had worked for Google, after all. The free lunch was back.

Now reality is reasserting itself once more, with familiar results. The number of companies that can be sustained by revenues from internet advertising turns out to be much smaller than many people thought, and Silicon Valley seems to be entering another "nuclear winter" (see article).

Internet companies are again laying people off, scaling back, shutting down, trying to sell themselves to deep-pocketed industry giants, or talking of charging for their content or services. Some Web 2.0 darlings (MySpace, YouTube) managed to find buyers before the bubble burst, thus passing the problem of finding a profitable business model to someone else (News Corporation and Google, respectively). But quite how Facebook or Twitter will be able to make enough money to keep the lights on for their millions of users remains unclear. Facebook has had several stabs at a solution, most recently with a scheme called Facebook Connect. Twitter's founders had planned to forget about revenues until 2010, but the site now seems to be preparing for the inclusion of advertising.

The bill, sir

The idea that you can give things away online, and hope that advertising revenue will somehow materialise later on, undoubtedly appeals to users, who enjoy free services as a result. There is business logic to it, too. The nature of the internet means that the barrier to entry for new companies is very low—indeed, thanks to technological improvements, it is even lower in the Web 2.0 era than it was in the dotcom era. The internet also allows companies to exploit network effects to attract and retain users very quickly and cheaply. So it is not surprising that rival search engines, social networks or video-sharing sites give their services away in order to attract users, and put the difficult question of how to make money to one side. If you worry too much about a revenue model early on, you risk being left behind.

Ultimately, though, every business needs revenues—and advertising, it transpires, is not going to provide enough. Free content and services were a beguiling idea. But the lesson of two internet bubbles is that somebody somewhere is going to have to pick up the tab for lunch.

On post-traumatic stress disorder, Barack Obama and Gordon Brown, Pakistan, helping the poor, the Amazon rainforest, pacemakers, recycling, emerging-market contagion

Mar 19th 2009
From The Economist print edition

Soldiers in harm's way

SIR – You recognise that post-traumatic stress disorder is a legitimate war injury, deserving of a Purple Heart ("Take heart", February 28th). But although it is true that suicide has "reached alarming levels among soldiers returning from duty", the same cannot be said for murder.

Statistics for 2003-05 from the Justice Department show that homicides committed by those aged 18-34 in the United States were 117 per 100,000. A very conservative estimate is that, over the same period, some 300,000 veterans returned from Iraq and Afghanistan. For them to be more dangerous than their peers those 300,000 veterans would have had to commit more than 352 murders. But the reality is that over a six-year period returning veterans committed or were charged with 121 killings, according to a special investigative series in the *New York Times* last year. We are clearly safer in the presence of our young returning troops than their peers.

We have a lot of work to do to create a more peaceful world, but fearing our soldiers is hardly helpful. The sad fact is our vets are more dangerous to themselves than they are to others. A Purple Heart might be just the thing to help alleviate their suffering.

Francois Melese
Professor of economics
Defence Resources Management Institute
Naval Postgraduate School
Monterey, California

Still on special

SIR – Despite misguided reporting on both sides of the Atlantic, the meeting between Gordon Brown and Barack Obama was a success (Bagehot, March 7th). It was a start at forming the structure of a global approach to solving our serious economic problems. There was a macro agreement about the main issues to be addressed, including the economy, security challenges and climate change. Both Britain and America seem to be on the same page. There will be some differences, but what is good about the "special relationship" is that both sides want and know they have to work these out in a reasonable way.

Harry C. Blaney III
Senior fellow
Centre for International Policy
Washington, DC

SIR – Attributing Gordon Brown's performance entirely to his preoccupation with pending electoral disaster short-changes a man whose grasp of history is keener than many in his party and certainly most in America, including many in Congress. He is acutely aware that the world has arrived at the end of the second era of globalisation without a plan and may fall back on the remedies of the first such era that produced even greater chaos than we are now witnessing. He may be on the way out, but that doesn't make him wrong about the clear and present danger of an American president embarked on a path that insists on regarding economic policy as purely domestic policy, and it certainly doesn't mean that David Cameron would fare any better as the outside pressure continues to rise.

Alison Holmes
Fellow of Transatlantic Studies

Yale University
New Haven, Connecticut

Terror in Pakistan

SIR – *The Economist*'s view of the attack on the Sri Lankan cricket team in Lahore in early March is as untenable as of those who hold India responsible for it ("State of denial", March 7th). Pakistanis are no more in "denial" about this problem than the British were about the Irish problem. The fundamental cause of Pakistan's violent discontent, as it was in Northern Ireland's in the 1970s and 1980s, is injustice. Pakistan is ruled, not governed, alternately by military and feudal lords who routinely destroy the rights of the people. They have thus wreaked havoc upon the wealth and rights of the people of Pakistan in general and those of the tribal areas in particular. Air-force pilots have been dismissed because they refused to shave their beards. Army officers have been posted to dead-end positions because of their religious beliefs.

Pakistanis understand that killing and oppression is making this problem worse. They also know that stopping it will resolve the problem in due course. The people of Pakistan need justice, democracy and freedom. You should stand with them in their fight for a free judiciary rather than calling for their government to crack down on them.

Riaz Raheem
Islamabad

Helping the poor

SIR – Your analysis that the poor are now being hit by the financial crisis is correct ("The toxins trickle downward", March 14th). But your conclusion that "progress towards a richer, more equitable world has been set back years" is premature. When G20 leaders meet in London, they must go beyond the limited ambitions of stimulus and trade-promotion you express ("The better part of valour", March 14th). Oxfam advocates a three-pronged approach: a fiscal stimulus of 3-5% of poor countries' income; a global agreement to rein in tax havens; and for rich countries to quickly meet their existing promise to give 0.7% of GDP in aid. Without urgent action, the pessimistic scenario you paint may become inevitable.

Kirsty Hughes
Head of policy and advocacy
Oxfam
Oxford

Human footprints

SIR – You continue to misrepresent the Amazon rainforest as "virgin" ("Preventing pillage in the rainforest", February 28th). Geographers, anthropologists and other scientists have by now clearly demonstrated that people have been active agents in the biome for millennia, selecting and managing biodiversity and creating small patches of soil throughout the basin. Granted, human activity has taken a destructive turn during the past few decades, but continuing to represent the forest as virgin does a disservice to the historical ecology of the region and feeds into its negative stereotype.

Antoinette WinklerPrins
Associate professor of geography
Michigan State University
East Lansing, Michigan

The heart of the matter

SIR – I read your article on pacemakers with great interest ("The rhythm of life", March 7th). I happen to be one of the few patients worldwide to be fitted with a nuclear device: a Plutonium 238-powered pacemaker, which was implanted in 1976. It is about the size of a small can of tuna fish and is still operating at near 98% efficiency. To my amazement, it has never had to be repaired. And despite

suggestions for ablation or a new, more “modern” Li-powered device, I have taken the stance of “If it ain’t broke, don’t fix it”, a philosophy that has provided me with 33 years of the gift of life.

Everett Nienhouse
Carlsbad, California

More worthy things to do

SIR – Your special report on waste (February 28th) suggests that one way to make recycling cheaper is “to get the household or business that generates the waste to sort it free of charge”. I live in San Francisco where the minimum wage is $9.79 an hour. Sorting one’s own garbage flies in the face of the economics of comparative advantage. Milton Friedman, for example, lived here before he died. What do you suppose an hour of his labour was worth?

Clive McCarthy
San Francisco

The following letter appears online only

Emerging difficulties

SIR - Your article on the risks to emerging markets of further financial contagion described the symptoms of the ongoing “sudden stop” in international capital flows, but does not get at its root cause (Economics focus, February 28th). Although certain emerging markets, particularly in central and eastern Europe, have overdosed on hard-currency credit, many others, particularly in Africa, had only just started to access international capital flows in recent years.

As the balance sheets of Western banks continue to shrink, the combination of government capital injections and loan guarantees is ensuring that any remaining credit is being drawn almost exclusively into the developed world. This financial protectionism, which is taking place while our political leaders continue to pay lip-service to free markets, threatens to reverse the gains made via market-based growth in emerging markets over the past decade and push millions back into poverty.

Michael Hugman
London

China and the West

A time for muscle-flexing

Mar 19th 2009
From The Economist print edition

As Western economies flounder, China sees a chance to assert itself—carefully

James Miles

THE room is stuffy on a sunny spring afternoon, and many of those packed into it (see above) must have regretted bringing their coats. The lucky ones have taken the few seats available. The rest are crammed shoulder-to-shoulder in this hotel-room office, listening intently to an hour-and-a-half rant on the threat of American imperialism and how the global economic crisis will result in growing confrontation between China and the West.

Sitting in front of a large portrait of a young Mao Zedong, Zhang Hongliang knows how to play to his nationalist, liberal-despising audience. His rambling discourse ranges from adulation of Mao to scorn of America (it has neither history nor culture), to warning of a “white terror” if rightists (liberals) prevail. The economic crisis is entirely the West’s fault, and as it deepens the West will turn on China. Now is the time to build an aircraft-carrier. A war with America would be “lose-lose”, but China should not be afraid of it.

China’s “leftists” are becoming more active as the global economy sputters. Mr Zhang belongs to an extreme fringe that pines for Maoist egalitarianism, state ownership and the certainty that America is an enemy. His seminar was organised by Maoflag, one of a clutch of like-minded websites in China whose nationalist, pro-communist rhetoric is suffused with a sense of their country as victim, yearning for revenge. Frequenters of these forums took heart from a flurry of spontaneous celebrations around the country in December to mark Mao’s 115th birthday. The government preferred to play it down.

Few would suggest that radical Maoists are poised to make a comeback. But their nationalism has a broad appeal. As China surveys the world, with the West in financial turmoil and its leaders seemingly desperate for cash-rich China to come to its aid, it sees strategic opportunities. Even before the financial crisis began to hit the country late last year, nationalism had been boiling up. It was evident in public responses to the turmoil in Tibet in March, the West’s support for the Dalai Lama, and China’s sporting triumph at the Olympic games in Beijing in August. Now a battered West presents a gratifying target for pent-up contempt. Even the normally cautious government is beginning to flex a little muscle on the world stage.

For most of the past two decades (flare-ups with Taiwan in 1995-96 and with America in 2001 excepted) China has played a cautious game internationally. Its approach was summed up in the pithy four-character phrases into which Chinese policymakers love to distil their thinking. The late Deng Xiaoping came up with a string of them: China should keep a low profile, not take the lead, watch developments patiently and keep its capabilities hidden. Now the global economic crisis and the West’s obvious weakness are causing officials to think again.

In public Chinese leaders still try to reassure. During a visit to Europe in late January and early February,

China's prime minister, Wen Jiabao, stressed that China's development was no threat to anyone. It would be, he said at Cambridge University (an event better remembered for the shoe lobbed in his direction by a protesting German student), a peaceful and co-operative great power. Some sensitive Western diplomats pricked up their ears at the phrase "great power", but it is one Mr Wen has used to describe China since well before the current crisis. In deference to foreign feelings, an English text released by the government news agency, Xinhua, used the word "country" instead.

On the issue of Tibet, however, China has been digging in its heels. Having conceded a little to Western opinion last year by holding three rounds of talks with representatives of the Dalai Lama in the wake of the unrest in March, China has lost interest. A massive security clampdown has been imposed on the Tibetan plateau to prevent any protests during this month's 50th anniversary of the uprising that caused the Dalai Lama to flee into exile in India. Foreign journalists (despite pleas for access) have been shut out altogether.

In late February China gave a warm welcome to America's secretary of state, Hillary Clinton. It had reason to feel proud. Here was an important American official clearly looking for China's help. Mrs Clinton—who once boasted how strongly she had emphasised human rights during a visit to Beijing in 1995—was now suggesting that China's bad record should not get in the way of co-operation on the financial crisis and global warming. Mr Zhang at the Maoflag seminar certainly enjoyed her new, soft tone.

Two weeks after Mrs Clinton's departure, Chinese boats (according to the Pentagon) harassed an unarmed American ship, the *Impeccable*, in the South China Sea. The ship was a mere 75 miles (120km) off China's coast and was probably on the lookout for Chinese submarines. But much as China objects, the American navy frequently deploys in international waters off China to monitor military activities. In this case Chinese responded more aggressively than usual, surrounding the American ship and trying to stop it from withdrawing. America later sent a guided-missile destroyer to protect the *Impeccable*.

A cautious poke

China clearly does not want to push this too far, mindful perhaps of the huge crisis in relations that occurred in 2001 when a Chinese fighter jet crashed into an American spyplane, forcing it to land at a Chinese airbase. The American crew was held for 11 days. This time China's response was to send a fishery patrol ship (hardly a match for a destroyer) to the area. But Shi Yinhong of Renmin University says the latest incident is a sign of new robustness in China's dealing with the West.

Though China may be unwilling to give America more than a cautious poke, it is a different story with Europe. Its abrupt decision to cancel a summit with the European Union scheduled for last December showed that, even amid the global crisis, it was prepared to deliver a powerful snub to leaders of its biggest trading partner. The reason was a meeting between France's president, Nicolas Sarkozy, and the Dalai Lama (France then held the EU presidency). The EU and China have agreed to reschedule their summit for later this year, but Mr Sarkozy is not yet forgiven. Wen Jiabao, the prime minister, avoided France during his recent European tour. "I looked at a map of Europe on the plane. My trip goes around France," he said.

Deng's advice on avoiding taking the lead has by no means been jettisoned. China has reacted coolly to suggestions that a solution to the world's economic problems lies essentially in the hands of two powers, China and America—what some call the G2. Fred Bergsten, of the Peterson Institute for International Economics, raised the idea in an article in *Foreign Affairs* last July. China, he argued, was continuing to act "like a small country with little impact on the global system at large and therefore little responsibility for it". Even well before the current crisis, China had been posing an increasing challenge to international rules and institutions, Mr Bergsten said: blocking progress in the Doha round of global trade talks, aiding foreign countries without regard to human rights or the environment and resisting adoption of a flexible exchange-rate policy. Better, he suggested, that China and America work together as a G2 "to provide joint leadership of the global economic system".

The head of the World Bank, Robert Zoellick, and its chief economist, Justin Yifu Lin, warmed to the G2 idea in an article in the *Washington Post* on March 6th. Though they did not repeat Mr Bergsten's criticism of Chinese "recalcitrance", they said that "without a strong G2, the G20 will disappoint". But some Chinese officials see a trap. *Liaowang*, a magazine published by Xinhua, said Chinese scholars believed the idea "would do harm rather than good". America would never cede control of the world order, and in any case China would never seek to exert hegemony.

China certainly delights in the notion that its global power is growing. As one Western diplomat put it, the

meeting between President Barack Obama and his Chinese counterpart, Hu Jintao, in the margins of the G20 summit in London on April 2nd will be far more important than the G20 meeting itself. China stole the limelight at the last G20 summit by announcing a 4 trillion yuan ($565 billion) stimulus package just before it. Rumours continue to circulate that it has another up its sleeve. That would please everyone.

But China is not (yet, anyway) seeking to knock America off its perch. It is pushing for a greater say for itself and other developing countries in the IMF, over which the Americans, in effect, wield a veto. But it is not demanding a veto of its own. At a press conference on March 13th Mr Wen avoided saying whether China would give more funding to the IMF to strengthen its ability to deal with the financial crisis. How much China gives, diplomats believe, will depend on how much of a say it gets. An article in the official *China Daily* newspaper on March 17th quoted an influential Chinese economist, Yu Yongding, as saying China should not give much to the IMF—not least because certain countries on the IMF's rescue list, particularly some from Europe, had an "anti-China mentality".

Buying into America

Some Chinese scholars and commentators have been circulating more radical visions of how China should use the current crisis to boost its strategic influence. A recent article in *Economic Reference*, a journal published by a government think-tank, said the crisis would severely weaken the economic, political, military and diplomatic power of developed countries. This would create an "historic opportunity" for China to strengthen its position. China should export capital to South-East Asian countries to strengthen their economies. By so doing, it would help prevent political turmoil and win strategic influence in the region.

In America, the article suggested, China should buy up businesses in order to acquire sophisticated know-how. If the American government balks at this, "the Chinese government absolutely can use its American dollar savings as a bargaining chip to force the American government to agree to China's acquisitions." Diplomats say threats have even been heard from lower-ranking Chinese officials that China might sell off American Treasury bills if Washington angers China on Tibet; a meeting between Mr Obama and the Dalai Lama, for example, could be a tripwire. Few believe that China would actually risk such a self-damaging tactic, but the airing of views like this suggests that some officials are acquiring more swagger. China's decision on March 18th to use anti-monopoly legislation to block Coca-Cola's $2.4 billion bid for Huiyuan, a Chinese juice manufacturer, will be seen as evidence of this by some in America (see article).

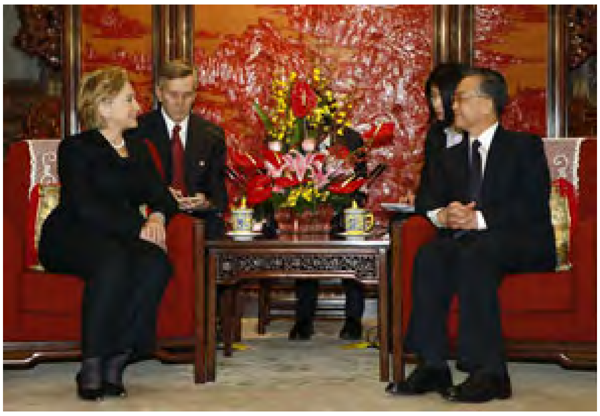
This self-assurance was on show, too, during a visit to Latin America by Vice-President Xi Jinping in February. During a meeting in Mexico with overseas Chinese, Mr Xi, who is widely believed to be the heir-apparent to President Hu Jintao, accused "well-fed foreigners with nothing better to do" of "pointing fingers" at China. His country, Mr Xi said, was not exporting revolution or poverty or hunger or "messing around" with other countries, "so what else is there to say?" Mr Xi's more diplomatic colleagues thought this was an outburst too far; though nationalist websites exulted, the domestic media were banned from reporting his comments.

Chinese leaders have been at particular pains to avoid giving the impression that China is wavering in its commitment to market capitalism (albeit with a heavy admixture of government control). But China's own economy is being battered by the turmoil. Officials estimate that some 20m migrant workers have lost their jobs as labour-intensive industries, churning out cheap products for export, put up their shutters. White-collar workers are beginning to suffer, too. Some are being laid off and many more having their bonuses and wages cut. China's leaders still say the country can achieve 8% growth this year, down from 9% last year; the World Bank, forecasting growth of only 6.5%, still notes that China is "a relative bright spot in an otherwise gloomy global economy". But the boom times are definitely over.

Adam Smith's disciples

Throughout the crisis China's leaders have railed against the dangers of protectionism, knowing that trade with the West is vital. Much to the chagrin of China's online leftists, Mr Wen has repeatedly sung the praises of Adam Smith in speeches and meetings with journalists. In London he revealed to the *Financial Times* that he was carrying Smith's "The Theory of Moral Sentiments" in his suitcase.

Reuters



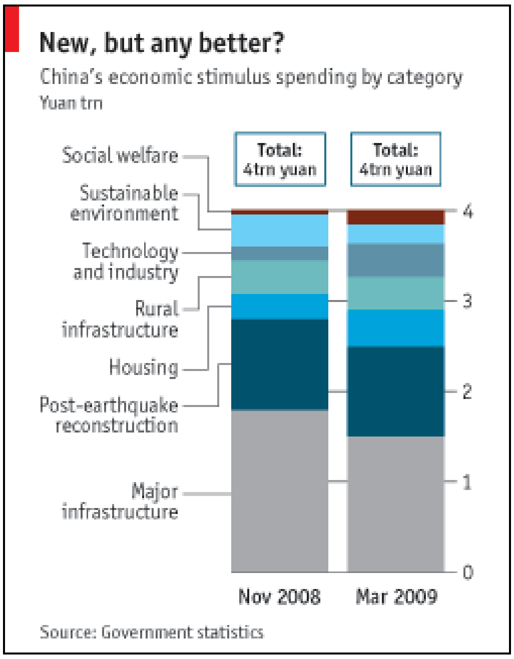
Hillary and Wen, great powers co-operating

As Mr Wen explains it, an important message of this book is that if the fruits of economic development are not shared by all, that is “morally unsound”, as well as a threat to social stability. This view resonates powerfully among the many Chinese who are embittered by the very uneven distribution of the fruits of China’s own rapid growth. Chinese leaders may be able to score points at home for standing up to their Western counterparts. But they know they are vulnerable to criticism that they are not doing enough to help Chinese victims of the economic slowdown. By emphasising this aspect of Smith’s philosophy, Mr Wen is trying to show he cares.

The government, however, does not want China to be roiled by the same debate that is plaguing Western governments over how to handle the crisis. This month’s annual session of the National People’s Congress, China’s parliament, was convened for only nine days instead of the usual two weeks. Although even the official media wanted more details of spending plans, the government-set agenda was strikingly sparse. The parliamentary chairman, Wu Bangguo, used the occasion to launch a lengthy tirade against Western-style democracy. “Leadership by the Party can only be strengthened and in no way weakened,” he told the delegates. For Mr Wu to get so worked up, serious voices must have been suggesting otherwise.

But few new details of the stimulus measures were revealed at the congress. The government airily said that details of a separate massive spending programme on health-care reform (850 billion yuan over three years) would be finalised only after the parliamentary session. In a cursory nod to public concern, it revealed that spending on welfare projects would be increased from 1% to 4% of the stimulus package (see chart). Spending on infrastructure would drop from 45% to 38%. But spending on environmental projects would also be cut from 9% to 5%. China’s commitment to greenness appears to be ebbing.

The left does have some cause for celebration. State-owned enterprises (SOEs) will be huge beneficiaries of the stimulus spending (Maoflag’s supporters are still in uproar about the dismantling of many of China’s SOEs a decade ago). But liberal economists in China fret that state-owned banks and their SOE cronies will carve up the spoils, leaving small and medium private enterprises by the wayside. They also worry that reforms may stall.



The China Institute for Reform and Development, a prominent liberal think-tank, has just published a 171-page report entitled “The International Financial Crisis Challenges Reforms in China”. It describes the economic crisis as the biggest problem the country has faced in the 30-year history of its reform-and-opening policy (and it has faced some big ones, not least the Tiananmen protests of 1989, the Asian financial crisis of 1997-98 and the SOE restructuring which threw millions out of work).

The report says that, without further market-oriented reforms, the stimulus package will not only fail to achieve its goal but will also store up long-term problems. In need of change, it says, are government controls on prices of water and power and government monopolies in industries such as telecoms, railways and aviation. It calls for faster financial reforms such as encouraging the development of non-state financial institutions, freeing controls on interest rates and allowing the yuan to float.

On March 13th, at the end of the parliamentary session, Mr Wen said that to counter the crisis China "would rather speed up reforms". He said it should "give full play to market forces in allocating resources" and encourage the development of the private sector. It must also, he said, carry on with political reforms in order to "guarantee people's freedom and rights". But the economic crisis will not have increased officials' appetite for change. Many will be all the more convinced that the government's big role in the economy (not least its ownership of the banks) and the country's one-party system (where else could a government announce such big spending plans without time-wasting debate?) are a help, not a hindrance.

It is more likely that, as the crisis deepens, the government will become increasingly cautious in its approach to domestic policy. But if protectionism grows in Western countries, Chinese nationalists will be all the more inclined to demand that their government stand up to them. A book published in China this month, "Unhappy China" (with an initial print-run of 70,000, says a publicist), aims to tap into what the authors believe is a widespread public feeling of disgruntlement with the West. One of the essays argues that the financial crisis could result in an envious West going to war with China to keep it down.

Few are quite that gloomy. One of the book's authors (speaking in a branch of Starbucks in a luxury mall) says the government worries about books like this because they fuel suspicions in the West that China is a threat. The publishers removed one part about India's annexation of Sikkim in 1975 because they thought it might upset India. China would like to be number one, but it would still rather get there without making big enemies.

Labour mobility

The road not taken

Mar 19th 2009 | WASHINGTON, DC
From The Economist print edition

Americans used to move to where the jobs were. But now home-ownership and health insurance freeze many of them to the spot

Corbis

NEELY WHITES bought a former crack house in New Orleans and fixed it up. It was looking really nice when Hurricane Katrina struck. In the storm's aftermath the neighbourhood where she lived turned even rougher than before. Weary of drive-by shootings, Ms Whites moved to Long Beach, Mississippi, and bought a house there in September 2006.

It was not the best timing. The property market promptly crashed. After fleeing a city that was literally under water, Ms Whites is now stuck in a home that is figuratively so. She would like to move closer to her new job as a financial consultant, cutting the daily commute from an hour each way to something less onerous. But she cannot sell her home. A nearly identical one on her street has been on the market for ages at $125,000 and found no takers. Ms Whites's mortgage is over $160,000. To make matters worse, she is in the middle of a divorce. Not being able to sell the house prolongs that painful process.

Mobility is part of the American dream. In "The Grapes of Wrath", when Tom Joad's farm in Oklahoma was repossessed he packed up his family in a sputtering truck and set off for California. Things didn't work out so well for John Steinbeck's hero. But throughout history, Americans have dealt with economic shocks by picking themselves up and moving on. Their mobility underpins America's flexible, dynamic labour market. Now it faces two threats.

One is the housing bust. House prices have collapsed by 27% since their peak in 2006. By December last year a fifth of homeowners with mortgages owed more than their homes were worth. Such people are only half as likely to move as those whose homes are above water, estimate Joseph Gyourko and Fernando Ferreira of the Wharton School of business.

Some cannot sell their homes at all. Others could, but don't want to take a big loss on an investment they thought was safe as houses. Either way, they are stuck. If a good job comes up in another town, they cannot take it. This effect is partly offset by the impact of foreclosures. Last month alone 291,000 homes received a foreclosure notice. The newly evicted are not merely free but obliged to move. This is unfortunate, but although jobs are in short supply nearly everywhere, being mobile at least increases the odds of finding one.

A decade ago Andrew Oswald of the University of Warwick in Britain argued that excessive home-ownership kills jobs. He observed that, in Europe, nations with high rates of home-ownership, such as Spain, had much higher unemployment rates than those where more people rented, such as Switzerland. He found this effect was stronger than tax rates or employment law.

If there are few homes to rent, he argued, jobless youngsters living with their parents find it harder to move out and get work. Immobile workers become stuck in jobs for which they are ill-suited, which is inefficient: it raises prices, reduces incomes and makes some jobs uneconomic. Areas with high home-ownership often have a strong “not-in-my-backyard” ethos, with residents objecting to new development. Homeowners commute farther than renters, which causes congestion and makes getting to work more time-consuming and costly for everyone. Mr Oswald urged governments to stop subsidising home-ownership. Few listened.

America subsidises more than most. Owner-occupiers typically pay no tax on capital gains and can deduct mortgage interest from their income-tax bills. Fannie Mae and Freddie Mac, two government-backed mortgage firms, have squandered a fortune promoting home-ownership among the uncreditworthy.

The other threat to mobility is health insurance. A company can buy health insurance for its employees with pre-tax dollars; an individual can buy it only with after-tax dollars. So although soaring premiums are prompting many firms to drop or restrict coverage, most Americans still get their health insurance from their jobs.

This makes it hard for anyone with a sick child to quit and start a new firm. It also makes it harder to switch jobs, despite a law helping employees to stay in company plans for 18 months after they leave. Scott Adams of the University of Wisconsin-Milwaukee found that married men with no alternative source of insurance were 22% less likely to switch jobs than those who, for example, could get covered by their wife’s employer.

Tying health care to a job can tie people to jobs they hate. Gerry Stover, who now runs a doctors’ group in West Virginia, recalls a time when his wife was pregnant and he couldn’t get health insurance at a private firm. He became a prison guard. As a public employee, his family was covered. But the job was neither pleasant nor a good use of his talents. “You have a radio and you’re put in a room with 70 criminals and told: ‘If they get you round the neck, press the [panic] button’,” he says. Some people even get stuck in bad marriages because they need their spouse’s health insurance. As Alain Enthoven of Stanford University puts it, this gives new meaning to the word “wedlock”.

The recession seems to have slowed internal migration. Only 11.9% of Americans moved house between 2007 and 2008—the most sluggish pace since records began in the 1940s. But not everyone has been immobilised. The postal service helps employees move by buying their homes and selling them at a loss. A postmaster in South Carolina recently sold his pad to his employer for $1.2m. “No wonder stamps cost so much,” grumbles a blogger.

California politics

Young man in a hurry

Mar 19th 2009 | SAN FRANCISCO
From The Economist print edition

Gavin Newsom wants to run California. Seriously

FOR the past few years Gavin Newsom has been a stimulus package for the conservative movement. His decision to allow gay marriages in San Francisco's city hall in 2004 was credited with provoking a big Republican turnout in that year's presidential race. Last year he unwittingly became the star of TV advertisements in favour of banning gay marriage in California. But not content with running a city loathed by conservatives, Mr Newsom now wishes to take charge of an entire state.

The young, handsome mayor (he is 41) has begun to raise money and hold town-hall meetings in preparation for a run at the office that Arnold Schwarzenegger will vacate at the end of next year. Mr Newsom joins a race that is thick with Bay Area politicians. Jerry Brown, the state attorney-general and former governor, grew up in San Francisco. So did Dianne Feinstein, the state's senior senator, who has hinted that she may enter the race. Both leading Republican candidates have stronger ties to Silicon Valley than to anywhere else in California. Only one likely contender, Antonio Villaraigosa, the mayor of Los Angeles, is from southern California, where most of the state's people live.

AP

Destined for great things?

Mr Newsom is not the loony liberal of conservative tirades. By Bay Area standards he is a moderate Democrat; in San Francisco he is sometimes accused of conservatism. He is the son of a judge and part of the city's Irish Catholic establishment. A former restaurateur, he claims to be pro-business, so long as that business is environmentally sound. Mr Newsom points out that San Francisco has one of the lowest unemployment rates in California.

With a population of about 750,000, San Francisco is no more than medium-sized (Phoenix, Arizona, is twice as big). That, together with the city's wealth, makes it a good place to experiment. Mr Newsom has tried to turn it into a Petri dish for new-media and biotech companies. He has tidied up the city somewhat and cut the number of rough sleepers. The city boasts a high recycling rate and strict green building standards.

Most important, for Mr Newsom's gubernatorial ambitions at least, he has expanded health care. Some 35,000 previously uninsured workers are now eligible for treatment by local clinics, paid for in part by a tax on businesses. With typical self-assurance, Mr Newsom claims that his model could be rolled out more widely if Barack Obama's health plan falters. Some of his schemes are outlined in a series of talks, available on YouTube, which run for more than seven hours and have earned him comparisons to Fidel Castro.

None of which throws Mr Newsom off his stride. He does not exactly deny the charge that his city is out of kilter with mainstream America. He just sees it as a pioneer, not an outlier. As he points out, the city handed out condoms long before the practice was mainstream. "Whether you support us or oppose us, we're always at the leading edge," he says.

The question that will determine Mr Newsom's chances next year is whether voters will punish him for being at the leading edge of the gay-marriage issue. Asked about this, Mr Newsom says he doesn't care. In fact, it may help him. To reach the governor's office he must survive the Democratic primary, where liberals dominate. And at least he has taken a bold, consistent stance on the issue. By contrast, Mrs Feinstein and (particularly) Mr Brown have twisted in the cultural winds. The gesture that made Mr Newsom so hated may yet make his career. And after California, who knows?

Taking on Congress

Obama's standing army

Mar 19th 2009 | WASHINGTON, DC
From The Economist print edition

Barack Obama’s election campaign runs on and on

IN 1980 Sidney Blumenthal published a book entitled “The Permanent Campaign”. One of the main reasons that Barack Obama beat Mr Blumenthal’s favoured candidate, Hillary Clinton, was because he promised a new kind of post-partisan politics, supposedly above all that continual warfare. Now that the election is over, however, he is proving to be just as keen on the “permanent campaign” as anybody else in politics.

Mr Obama is currently deploying the formidable resources he built up during his campaign—including contact details for 10m donors, supporters and volunteers—to sell his policies. David Plouffe, the man who managed Mr Obama’s presidential campaign, has sent millions of e-mails to encourage them to support the White House’s agenda.

One of them contains as good a definition of the permanent campaign as any: “In the next few weeks we’ll be asking you to do some of the same things we asked of you during the campaign—talking directly to people in your communities about the president’s ideas for long-term prosperity.” Another, which includes a video of the president, asks supporters to put pressure on their congressman to pass Mr Obama’s budget, by calling his or her office and reciting a little pro-Obama speech.

Mr Obama frequently looks like a man in campaign mode. He has delivered a striking number of speeches in swing states which he needs to retain in 2012, for example. Democratic pressure groups are also fuelling the campaign atmosphere. MoveOn.org has sent millions of e-mails talking up Mr Obama’s budget as “ambitious, amazing and unapologetically progressive”.

Apart from singing the virtues of the president’s policies, his allies are also busy demonising the other side. The aim is to present the Republicans as the party of “no” and as the puppet of unpopular figures such as Rush Limbaugh. When Dick Cheney suggested, on March 15th, that Mr Obama’s policies were making the country less safe, Robert Gibbs, the president’s press secretary, immediately shot back: “Well, I guess Rush Limbaugh was busy, so they trotted out the next-most-popular member of the Republican cabal.”

Why is Mr Obama abandoning one of his central election pledges? Partly because he is surrounded by hard-nosed strategists, such as David Axelrod, who excel at campaigning. But also because he is worried about his political momentum. The administration’s difficulties with various nominees have created an unfortunate impression of incompetence. His poll numbers are sliding. And the combination of pork-stuffed legislation and scandal-riven bail-outs threatens to create a populist backlash.

Virginia

Friends in high places

Mar 19th 2009 | RICHMOND
From The Economist print edition

A White House hand in a governor's race

THE governors' races in Virginia and New Jersey, which fall this year, may be mini-referendums on Barack Obama. Both states voted for him last November. But will they stay in the Democratic camp?

The Virginia contest, just across the Potomac river from Washington, DC, may be particularly telling. Unlike the New Jersey governorship, where Democrat Jon Corzine, an unpopular former titan on Wall Street, is seeking a second term, the Virginia office is open. That is because Virginia, alone among the states, bans governors from running for consecutive terms.

Timothy Kaine, an early supporter of Mr Obama's, will be leaving Richmond to become the national chairman of the Democratic Party. Three men are jostling for the Democratic nomination to replace him. The primary is on June 9th.

When Mr Obama carried Virginia—the first Democratic presidential candidate to win the state in 44 years—Terry McAuliffe, the Democratic national chairman under Bill Clinton, parachuted into the race. Until then, he had shown little interest in state politics. A native New Yorker, he has lived in Virginia for almost 20 years, mostly in McLean, a posh suburb of the capital favoured by fellow Washington power-brokers. He comports himself more like a carnival barker than a candidate, loudly promising jobs in a state where unemployment jumped from 5% to 6.4% between December and February. His celebrity and the profligacy of his campaign have jazzed up a subdued election.

A quiet ride would have been fine with Mr McAuliffe's opponents. Brian Moran and Creigh Deeds are Democratic workhorses who were broken in as local prosecutors before long careers in the state legislature. They were content, before things got heated, to talk about Virginia's unfinished business, including long-overdue transport improvements and redistricting.

After more than 20 years in public life in Virginia Mr Moran still keeps the edgy accent of his native Massachusetts. It is a reminder that Virginia politics is increasingly dominated by "come-heres": people born and educated elsewhere. They are particularly abundant in northern Virginia, Mr Moran's base, and their more moderate views have fuelled a Democratic ascendancy in the state since 2001.

Mr Deeds may be the most seasoned candidate. He only just lost a race for attorney-general in 2005. He is also one of the state's last rural Democrats and, as such, an opponent of gun control. That could imperil him with the liberals who are likely to flood the Democratic primary.

No matter who wins the nomination, the retiring governor and his friend in the White House will have a big say in the election. As Democratic chairman, Mr Kaine will steer millions of dollars to the nominee. And Mr Obama can help raise it.

Virginia Republicans had hoped that their candidate, the unopposed Bob McDonnell, once attorney-general, would benefit from the split Democratic race. He now seems a bit sidelined by the buzz; but Republican strategists are still extremely hopeful of winning both Virginia and New Jersey in November, and putting a big dent in Mr Obama's crown.

Charities

Taking from the givers

Mar 19th 2009 | NEW YORK
From The Economist print edition

Charitable foundations fear new restrictions

THE world of philanthropy faces a three-pronged attack. First, philanthropic institutions have been hit by the impact of recession on charitable giving. Next, last month, Barack Obama's budget proposed to limit tax deductions on donations by individuals earning over $200,000. But America's proud charitable foundations are also worried about another threat: political pressure to increase the "diversity" of their employees, with hints of racial and sexual quotas on employment and even on recipients.

In a paper released on March 12th the Philanthropy Roundtable, a group based in Washington, DC, described this diversity initiative, first instigated in 2007 by the Berkeley-based Greenlining Institute, as a shakedown for the benefit of the already privileged professional elite in the minority workforce (that is, blacks and Latinos). Heather MacDonald of the Manhattan Institute thinks this "diversity police" will discourage personal giving by diverting charities from their true objectives and will transform foundations into job-creation schemes for minorities.

Others object. Pablo Eisenberg of Georgetown's Public Policy Institute argues that such "right-wing hammering" has deliberately "confused the issues". And Chris Vaeth of Greenlining admits his institute only wanted "to start a conversation" about ethnic representation but "unwittingly began a conversation on general oversight". The outcome, though, was a California bill requiring all foundations with assets of over $250m to report the race and sex of their boards and staff. Although this bill was withdrawn after heavy lobbying, similar initiatives are moving forward in several states. Now Congress is getting in on the act.

On March 10th Charles Grassley, the senior Republican on the Senate Finance Committee, said he wanted to explore transparency and accountability in foundations, arguing that "sunshine is the best disinfectant". Xavier Becerra, a Democrat from California, has threatened to remove tax exemptions for foundations.

This sort of partisan interest could allow lawmakers to "insert themselves into foundation governance and grant-making", worries Sue Santa of the Philanthropy Roundtable. Philanthropists fear America may go down the British route, where charities must show clear public benefit to qualify for tax deductions; and that will open the door to politics.

Electricity

Smart move

Mar 19th 2009 | CHICAGO
From The Economist print edition

The push for a more intelligent grid

THE Illinois Institute of Technology (IIT) has always exemplified efficient design. Ludwig Mies van der Rohe, a master modernist, filled its Chicago campus with simple rectangular buildings. Critics quipped that IIT's only church spire was the chimney of its power plant. It is fitting, then, that IIT should herald a new era of efficiency. With the help of the Galvin Electricity Initiative, it is adopting the electric grid of the future. The hope is that the rest of the country will soon have one, too.

Electrocrats have been plugging the "smart grid" for years. Now others have joined them. Barack Obama's stimulus package contains about $4.5 billion in grants for smart-grid investments and regional demonstrations. GE is promoting the smart grid with ads that show a scarecrow singing "If I only had a brain" from "The Wizard of Oz" while bouncing along an old power line. In January Mr Obama declared that a smart grid could "save us money, protect our power sources from blackout or attack, and deliver clean, alternative forms of energy to every corner of our nation"—grand goals indeed.

America's power system has changed remarkably little over the past century, with centralised utilities delivering electricity to passive consumers. A smart grid would use digital technology to collect, communicate and react to data, making the system more efficient and reliable. For example, sensors would help utilities locate problems and fix them quickly—power cuts now cost businesses more than $100 billion each year. A nimble grid would integrate electricity from both predictable sources, such as coal, and fickle ones, such as the sun and wind.

Meters, to monitor both use and prices, would give consumers more control over their electricity bill. Advocates predict that some consumption would move to cheaper, off-peak hours, easing congestion and reducing the need for new infrastructure. Consumers would save money and emissions would fall. Installing smart meters in 25% of American homes, GE estimates, would be equivalent to removing 1.7m cars from the roads. Plug-in hybrids, meanwhile, could charge at night, when demand is low, and even pump power back to the grid while parked during the day.

The pilot at IIT is one of many. Xcel Energy, a utility, is transforming Boulder, Colorado, into what it calls the world's first "smart grid" city. The smart grid, however, should not be confined to pilots. But the problem is figuring out how to scale up.

Advocates have many tasks, not least of which is convincing consumers that a smart grid will lower their costs, not raise them. Changing regulations, meanwhile, is even thornier. For utilities, reducing consumption means reducing revenues, hardly an appealing prospect. The stimulus encourages rewarding utilities for efficiency, but it is local commissions that must change the rules, and they may be wary of what is still seen as a risky investment. Illinois's regulatory commission approved the installation of up to 200,000 smart meters in 2009. Wider investments, however, await a two-year cost-benefit study.

At the national level, standards are needed so that innovations can interact seamlessly. The National Institute of Standards and Technology, part of the Commerce Department, is expected to present only a rough framework by the summer. The momentum for a smart grid continues to build. But God, as Mies liked to say, is in the details.

Rounding up rattlesnakes

The old enmity

Mar 19th 2009 | SWEETWATER, TEXAS
From The Economist print edition

Wrangling some tough customers

DAVID SAGER told the crowd that he once saw a rattlesnake get in a fight with a roadrunner. The bird ran back and forth across the yard, exhausting the snake, who eventually curled up in defeat. The roadrunner strutted. Mr Sager, intrigued, walked over and touched the weary rattler. There was no reaction. “The roadrunner had so worn down and cowed him that all he wanted to do was just hide,” he said.

The point, said Mr Sager, was that rattlesnakes should be respected but not feared. He was running a safety demonstration during the Sweetwater Jaycees World’s Largest Rattlesnake Round-Up. There was a large rattlesnake on the table, flicking its black tongue and rattling furiously, and several dozen more coiled on the floor of the pit.

Members of the Jaycees, a civic organisation, were weighing snakes, measuring them and milking their venom. Eventually some rattlers went to the “processing” pit, where they were decapitated, skinned and gutted. A Jaycee said there was no reason to be squeamish. “That right there is fresher than any steak you ever bought,” said Mike Hurd, pointing to the barrel of skinless, headless snakes. It tastes a bit like chicken, but gamier and chewier.

Rattlesnake roundups are a comparatively recent development. The Sweetwater event began in 1958 for ranchers who were concerned about rattlesnakes biting their cattle, and has evolved from a simple hunt to a days-long affair. Hunters from the surrounding area bring in all the Western diamondback rattlesnakes they can catch (“in good condition only”). Some of these are fried and eaten during the round-up, but most are sold to wholesale buyers for meat and skins.

The round-up includes guided snake hunts, a pageant and dances at night. There is a contest to see who can catch the longest rattlesnake, and another to see who can eat the most fried snake. It is a big weekend for a small town, and the Jaycees distribute the proceeds to worthy local causes.

The American Society of Ichthyologists and Herpetologists opposes rattlesnake roundups, as does the Humane Society. Critics say that they are unnecessary and cruel to rattlesnakes, a creature long considered a symbol of American courage and resilience. Texans are unimpressed; in these parts, rattlers sometimes even get into your house.

Statewatch: Texas

Nowhere to hide

Mar 19th 2009 | AUSTIN AND SWEETWATER
From The Economist print edition

Even America's most robust big state is suffering

AT A popular café in Sweetwater, Texas, a lunchtime crowd gathered for a home-style spread of chicken, brisket, beans, corn and cobbler. A group of men passed the time talking about their children, the oil business, and big-government liberals: how, exactly, were they planning to pay for their stimulus package? The men had reason to complain: oil is trading at less than $50 a barrel. Still, they were sanguine. A man from Coahoma even had a sympathetic word for Barack Obama: he himself had been on the city council for 12 years, and it was nothing but a headache.

Their calm is not so surprising. Times are tough in Texas, and things will get worse before they get better. But compared with what has happened in other states, Texas's wounds are scratches.

Until recently some watchers thought Texas could dodge the downturn altogether. The state began 2008 in fighting form. In January 2008 unemployment was just 4.4%, according to the Texas Workforce Commission (TWC). Important parts of the economy such as manufacturing, exports and energy were soaring. The state added thousands of jobs each month, more than any other state, although unemployment kept inching upwards. The housing crisis looming over much of the country seemed manageable; home prices had never reached stratospheric levels.

Then things changed. Tom Pauken, the chairman of the Texas Workforce Commission (TWC), says the trouble started when Hurricane Ike made landfall last September. The storm caused billions of dollars' worth of damage to Houston and Galveston and, just as the state was picking up the pieces, Hurricane Wall Street roared in. Here, as in housing, Texas was not especially hard-hit. But it was hit hard enough. "We can't control our situation any more because of the credit issues," says Mr Pauken.

Now there is almost nowhere to hide. Exports have fallen since the dollar started to strengthen against the euro and the pound. Manufacturers are reporting sharp declines in production, new orders and shipments. Almost half of those included in a monthly survey by Federal Reserve Bank of Dallas have cut jobs. Oil and natural-gas prices are down.

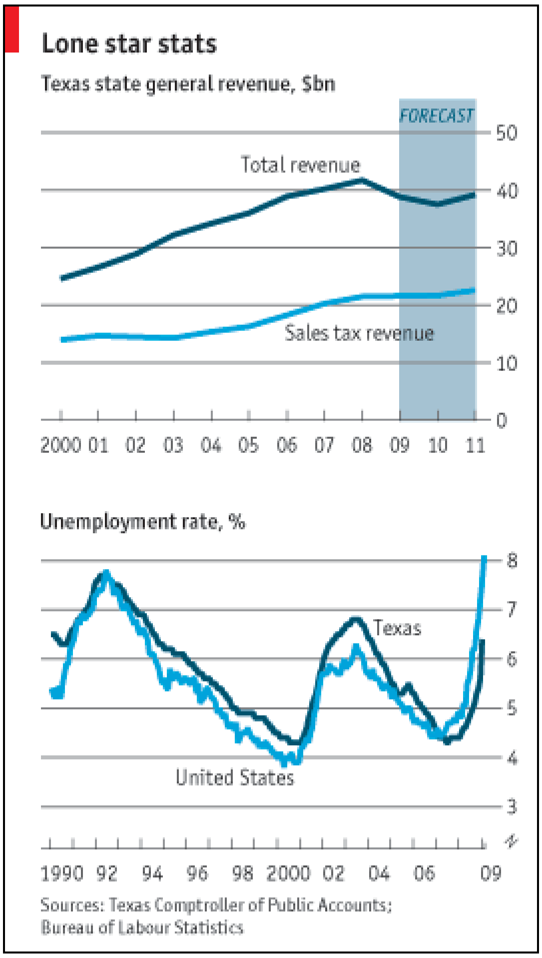
Tech companies in Austin, including Dell, AMD and Freescale, have cut hundreds of jobs. Southwest Airlines, based in Dallas, plans to reduce its fleet. Peanut farmers are struggling after a salmonella outbreak killed eight people around the country and spooked customers.

In December 2008 and January 2009 the state lost tens of thousands of jobs. Unemployment reached 6.4% in January. (That was more than a point below the national level, 7.6% in January.) And the worst is to come. Susan Combs, the state comptroller, has estimated that Texas will lose 111,000 jobs in 2009. Keith Phillips, a Fed economist based in San Antonio, has a gloomier perspective: he recently predicted that almost 300,000 jobs will go.

There are some bright spots. *Builder*, a trade publication, recently ranked America's healthiest housing markets. The five top spots went to Houston, Austin, Fort Worth, San Antonio and Dallas—all in Texas. The number of starts had slowed in each city, but all added jobs and people in 2008. "We've seen better days, but we're not pitiful," says Kay Vinzant, of the Heart of Texas Builders Association.

Education and health care are growing along with the population. The state's energy industry has become more broad-minded. Ten years ago Sweetwater was a dusty backwater best known for having the world's largest rattlesnake round-up (see article). Today it is the windpower capital of the country.

Ray Perryman, an economist who focuses on Texas, mentions another point of solace: state finances are in reasonably good shape. The comptroller, in her biennial revenue estimate, predicted that Texas would have about $77 billion to spend in 2010-11: down 10.5% from the previous round, because of declining sales and property taxes. Fortunately the state has several billion dollars in its Economic Stabilisation Fund, set aside against the possibility of a downturn. With Texas's share of the federal stimulus set at $17 billion, the state may not even need to tap this "rainy day" fund. But even if it comes through the downturn in relatively good shape, there is the future to worry about. Many now fear that Texas's low-tax, low-spend model will need revision.



Lexington

The other Obama

Mar 19th 2009
From The Economist print edition

Let Michelle be Michelle

Illustration by KAL

BY ANY measure Michelle Obama is a remarkable first lady. She is highly educated, with degrees from Princeton and Harvard, and professionally accomplished, having worked for a top law firm, a big-city government and a big hospital. And she is the first first lady who is the direct descendant of slaves.

Yet what have we heard about this paragon since her husband won the election? That she likes to display her “perfectly toned” arms in public. That she has a penchant for mixing designer clothes with J. Crew. That she and her husband had a romantic dinner together in a four-star Italian restaurant.

Shortly after the election Rebecca Traister took aim in Salon, an online magazine, at the “momification of Michelle”. But since then Americans have been forced to endure the “Oprah-isation” and “Jackiefication” as well. Mrs Obama has graced the cover of Oprah Winfrey’s magazine *O*, made several appearances on low-end talk shows and earned the sobriquets “America’s next top model” and “leader of the fashionable world”.

The news stories about Mrs Obama are almost entirely devoted to fluff. CNN has run a segment on “how to get Michelle Obama’s toned arms”. Every fashion magazine worth the name has run pieces on “the secrets of Michelle’s style”. During the presidential campaign the *New Yorker* published a cover cartoon of Mrs Obama, complete with an Afro and a machine gun, exchanging a “terrorist fist jab” with her husband; the cover of the March 16th issue features the first lady strutting on the catwalk in three different outfits (none of them featuring bare arms).

This is more than just a response to public demand. The White House has been doing its best to turn the first lady into a celebrity mother-cum-clothes-horse. Her White House website describes her “first and foremost” as “Malia and Sasha’s mom” before adding that, “before she was a mother”, she was “Fraser and Marian Robinson’s daughter”. The White House has even engaged in debates with the press about whether Mrs Obama ought to go bare-armed to formal events.

It is not difficult to understand why the White House has chosen this tack. Hillary Clinton’s determination to act as a virtual co-president back in 1993 helped to create a backlash against her husband’s administration. It also raised uncomfortable questions about power and accountability. Given America’s

continued neuroses about race, an outspoken black first lady might prove to be even more divisive than an outspoken white one.

Mrs Obama is carrying a certain amount of baggage of her own—though not as much as Mrs Clinton. The Chicago hospital where she worked increased her salary from $122,000 to $317,000 shortly after her husband became a senator. She and her husband bought their $1.65m house with the help of a local property developer, Tony Rezko, who is now in prison. There is no shortage of conservative journalists who are willing to present her as “the bitter, anti-American, ungrateful, rude, crude, ghetto, angry Michelle Obama”, to quote one blogger.

So why not just wrap her in designer clothes and be done with it? Mrs Obama’s favourability rating now stands at 63%, up from 32% a year ago. She has embraced an admirable collection of good causes—helping women balance their careers and their families, supporting military families and encouraging national service. And recession-racked America craves a bit of glamour.

But there is a danger that the White House is overreacting to Mrs Clinton’s failures back in 1993-94, and a worry that all this fluff is both demeaning to Mrs Obama and disappointing for some of her husband’s most passionate supporters, particularly professional women. Mrs Obama did not campaign as a traditional first lady, staring at her husband with dewy-eyed admiration and limiting her comments to bland pleasantries. She criss-crossed the country giving her own speeches. And powerful speeches they were too: intelligent, substantive and well-delivered. She was particularly important in shoring up her husband’s support among blacks (who were suspicious at first of his exotic background) and professional women (who were attracted to Hillary Clinton), earning the nickname “the closer” from the campaign for her ability to get people to sign up with Mr Obama.

Unleash her

Mrs Obama has a unique ability to act as an advertisement for the virtues of hard work and stable families. She grew up in a solid working-class family on Chicago’s tough South Side, sitting down to family dinner every night, attending a local magnet school and following her brother to Princeton. She is now repeating this virtuous pattern with her own children.

Mrs Obama also has a unique understanding of the precariousness of black life. Born six months before LBJ signed the Civil Rights Act, she has benefited from the explosion of opportunities for blacks in both higher education and the professions. But, as a child of an area that became the subject of William Julius Wilson’s classic book “When Work Disappears”, she also knows the devastation that job losses, drugs, crime and family break-up have wrought on the black working class. More than 60% of black children these days are brought up without a father.

It is arguable, of course, that Mrs Obama is already doing enough to inspire her fellow Americans without running the risks inherent in pronouncing on policy. But during the campaign she raised a lot of thought-provoking questions—about “the flimsy difference between success and failure” in America, about the removal of rungs from the ladder of opportunity, and about the plight of families at the bottom of the heap. It would be good to hear a bit more about what Mrs Obama thinks and a lot less about what she wears.

Lexington now writes a blog, which is open for comment at
Economist.com/blogs/lexington

Mexico and the United States

Don't keep on trucking

Mar 19th 2009 | MEXICO CITY
From The Economist print edition

Mexico retaliates against American congressmen who want closed borders

AP

IN JANUARY Mexico's president, Felipe Calderón, became the only foreign leader to meet Barack Obama between his election and his inauguration. Their long lunch was a success. Mr Obama said afterwards that he would be "ready on day one to build a stronger relationship with Mexico." According to one Mexican official present at the talks, the visitors felt reassured that Mr Obama would resist protectionist pressures and that the criticisms of the North American Free-Trade Agreement (NAFTA) he had expressed during the campaign could be dealt with in a trilateral review, involving all three North American countries, that would seek to improve the agreement rather than unpick it.

Just two months later, the honeymoon has soured somewhat. Mr Calderón has taken to lambasting American officials for allowing the illegal drug trade between the two countries to flourish, and to criticising the American media's coverage of Mexico's drug-related violence. Now a provision inserted into the Omnibus Appropriations Bill signed into law by Mr Obama has scrapped a pilot programme that allowed a small number of Mexican trucking companies to carry cargoes north of the border—as NAFTA requires.

Mexico's response was swift. On March 18th it imposed tariffs of up to 45% on 90 American agricultural and industrial imports, ranging from strawberries and wine to cordless telephones. The list was carefully chosen to avoid pushing up prices of staples in Mexico while hitting goods that are important exports for a range of American states. That way, it could have maximum political effect north of the border.

Since NAFTA was signed in 1992, trade between Mexico and the United States has boomed. But the issue of road transport has turned into a political battle. Around two-thirds of cross-border trade goes by road. Transport companies from each country were supposed to be able to operate freely in the others by 2000. The Teamsters union, whose members include American truck drivers, has fought a long and largely successful rearguard action against this provision. It argues that Mexican trucks are unsafe and polluting and their drivers insufficiently trained.

An American court rejected these arguments. So did a NAFTA dispute-settlement panel, which ruled in 2001 that the United States was violating the agreement and gave Mexico the right to impose retaliatory tariffs. Mexico chose not to do so, to give the United States a chance to honour its commitment. The

Bush administration tried, but was thwarted when Congress approved a measure setting 22 new safety standards for Mexican trucks.

To try to break this stalemate in 2007 the Bush administration set up the pilot programme, under which trucks from 100 transport firms in each country were allowed to cross the border. Opponents in Congress slipped a provision delaying this into an unrelated bill. This was hailed by James P. Hoffa (son of Jimmy), the Teamsters' president, as a victory in "the battle to keep our borders closed". But the pilot scheme eventually went ahead.

The Teamsters' safety argument looks spurious. Mexican transport firms have invested in new trucks and trained their drivers to meet the safety requirements under the pilot scheme. A study commissioned by America's Department of Transportation, which tracked Mexican trucks operating north of the border in the first year of the programme, found that these trucks clocked up far fewer safety violations than their American counterparts.

The Teamsters' victory means that most Mexican goods going north will continue to have to be unloaded at the border, reloaded for the short hop across it, then loaded again onto an American truck. This amounts to what Mexicans call a "trucking tax". And since the short-haul lorries tend to be older gas-guzzlers, it is environmentally unfriendly, points out Barbara Kotschwar, a trade specialist at Georgetown University in Washington, DC. No such restrictions apply to Canadian lorries.

Mexico had the right to impose bigger tariff rises. Its government hopes the dispute can still be settled. The American administration said it would try to come up with a new scheme to meet the "legitimate" concerns of Congress. That will be a job for Ron Kirk, confirmed this week by the Senate as United States Trade Representative. But Mr Obama's early capitulation to a transparently protectionist lobby sets a worrying precedent. On March 25th Hillary Clinton, the secretary of state, will visit Mexico, dispatched by Mr Obama originally to discuss security issues. Her task will now also be to reassure America's second-biggest trade partner that her country honours its commitments. Perhaps Mexican officials should invite her to make the return journey by truck.

El Salvador's presidential election

Left turn

Mar 19th 2009 | MEXICO CITY
From The Economist print edition

The voters opt for "safe change"

EPA

The fireworks may be just beginning

IN HIS victory rally after El Salvador's presidential election on March 15th—as he had done throughout the campaign—Mauricio Funes wore a white tropical *guayabera* shirt, rather than the red favoured by the former guerrilla leaders of his left-wing Farabundo Martí National Liberation Front (FMLN) who stood behind him. His triumph was historic for his country: by the narrow but clear margin of 51.3% to 48.7% Mr Funes defeated Rodrigo Ávila of the ruling Arena party, ending two decades of rule by the right (and centuries of its domination). His sartorial message was equally clear: he stands for moderate social-democratic policies in the mould of Brazil's Luiz Inácio Lula da Silva, rather than the more radical leftism of Salvador Sánchez Cerén, the former guerrilla commander who is the new vice-president.

For the non-partisan observer—and there are few in El Salvador, a country still marked by a civil war in the 1980s in which 75,000 people died—the FMLN's victory was a move towards institutionalising democracy. Arena, whose origins lie in the army and right-wing death squads, stayed in power so long partly because it became a civilian conservative party, but partly too because the FMLN's past two presidential candidates were former guerrilla chiefs with hardline views.

Arena at last lost its grip on power because Mr Funes, a television journalist with no ties to the war, convincingly promised "safe change". It also had itself to blame. Tony Saca, the outgoing president, failed to maintain his country's claim to be a Central American economic tiger. Mr Ávila, a former police chief, ran a relentlessly negative campaign that sought to portray Mr Funes as a pawn of Venezuela's Hugo Chávez. But Mr Ávila was quick to recognise his defeat, dissipating fears that a close result would spark violence.

In victory Mr Funes called on the country to unite to face its formidable problems of impending recession and endemic crime. To make matters worse, remittances from some 2.5m Salvadoreans abroad, which accounted for 17% of national income last year, are falling. They could shrink by 8% this year, reckons Ricardo Esmahan, the outgoing economy minister.

In a country where incomes are very unequal, Mr Funes has promised to increase taxes on the rich to pay for better social programmes, including rural health care and crime prevention. He wants to give subsidised credit to farmers and small businesses. But he has also vowed to keep the American dollar, adopted by an Arena government as El Salvador's currency in 2001. This week he reiterated his respect for property rights, economic stability and fiscal discipline. He also said he would seek to preserve El Salvador's close ties to the United States.

This balancing act will not be easy. Some of the former guerrilla commanders would like to emulate the more radical approach of Mr Chávez. But the FMLN failed to win a majority in Congress in an election in January, and will need to try to reach agreements with conservative parties. In his victory speech Mr Funes called for the "same sentiments of hope and reconciliation" that inspired the peace agreement of 1992. They will be needed.

Brazil's banks

Spread bets

Mar 19th 2009 | SÃO PAULO
From The Economist print edition

A different sort of banker-bashing

WITH the economy sliding towards recession, at least Brazil's Central Bank finds itself able to cut interest rates hard and fast. On March 11th it slashed its benchmark Selic rate by one-and-a-half percentage points, to 11.5%. Further cuts are expected. A welcome novelty: in the past, a fragile currency and roaring inflation prevented such counter-cyclical measures. But the rate cuts are not being passed on fully to borrowers, fanning an argument about the fat spreads charged by Brazil's banks (ie, the difference between the rates at which they borrow and at which they lend).

According to a calculation by the Institute for Industrial Development (IEDI), a lobby group, Brazil has the highest bank spreads in the world, even if they are a bit lower than they were (see chart). The Brazilian Federation of Banks disputes these figures, claiming that they compare apples with *jabuticaba*. The banks say that the spreads are inflated by taxes on banking transactions.

The government thinks the banks could do much more to lower the cost of credit. It is considering ordering state-owned banks—there are three giant ones—to take over some small private banks and lend at lower rates. But sceptics note that some of the state banks, which account for around 40% of the system, pocket spreads which are as high as those of their private rivals.

In a study of bank spreads, the Central Bank concludes that in 2007 the biggest single element (37.5% of the total) was profit. But provisions for loan default were almost as large, and will rise as the economy worsens. The banks blame their high level of loan-loss provision on the frailty of Brazilian courts, which are slow and often kind to debtors.

The third-biggest chunk of the spread comprises taxes. The private banks say there is a fourth element: the directed loans the government obliges them to make at subsidised rates to favoured groups (such as farmers and small businesses) require them to charge their other clients more. They also have to deposit half of their reserves at the Central Bank, for a low return.

Brazil's banks may be expensive, but at least they are safe. None has yet been troubled by the world financial turmoil. That may be because their profits from everyday banking were so high that they had no need to take silly risks. It is also because bank regulation was tightened after several went bust when inflation was tamed in the mid-1990s.

As evidence that the market is open, bankers point to Spain's Santander, which has a reputation for competing aggressively on consumer loans and mortgages and which is now Brazil's third-biggest private bank. But Santander's Brazilian operations are half as profitable again as its worldwide average. HSBC and Citibank have small operations in Brazil, which are doing nicely. One way or another, Brazilian banking seems likely to remain a profitable exception to the disasters elsewhere.

Land rights in Peru

Whose jungle is it?

Mar 19th 2009 | TARAPOTO
From The Economist print edition

A scramble for land sets investors against locals

THE San Martín region in northern Peru is a large swathe of tropical land the size of Costa Rica where the eastern foothills of the Andes merge with the Amazon jungle. It used to be best known for drugs and terrorism: its rugged hillsides were perfect for coca, the raw material for cocaine, and as hideouts for the Maoist Shining Path guerrillas. Now that both have largely disappeared from the area, and long stretches of the Marginal Highway, a road connecting it to the Pacific coast, have been surfaced with asphalt, San Martín is seeing a scramble for land.

While some neighbouring countries shun multinationals and harry local businesses, Peru's president, Alan García, is convinced that private investment, both local and foreign, is the best way to haul his people out of poverty. His government, like its similarly-minded predecessor, has granted land concessions for oil and gas exploration, mining, biofuel crops and logging. The problem is that many of these are superimposed on towns, farms and natural parks. That is a recipe for conflict.

"About a quarter of our region has been granted in concession without anyone letting us know," says Ulderico Fasanando, an official in the regional government. Locals are particularly worried about the fate of the Cordillera Escalera, a mountain range that is the water source for Tarapoto, the region's largest town, and is home to villages of small-scale farmers and several endangered wildlife species, including the spectacled bear.

A local request to declare the range a protected environment was filed in 2000, but not approved by the government in Lima until 2005. In the interim, the government had included the area in an oil and gas concession now held by a consortium involving Canada's Talisman Energy, Brazil's Petrobras and Spain's Repsol. Last month the Constitutional Tribunal, Peru's highest court, ruled that exploration should halt in the protected area while the government comes up with a development plan. Greens and civic groups in San Martín fear that this will approve exploration, and are gearing up for a long and nasty fight. Semira Pérez, the leader of this coalition, complains of graffiti labelling her a terrorist, and of death threats.

Another dispute involves a plan to plant 3,000 hectares (7,400 acres) of oil palms for biofuel in Barranquita by the Romero group, one of Peru's biggest business conglomerates. Opponents say the government illegally redesignated this land from forest to farmland, and complain of harassment by the company. The Romero group says the project was approved by local, regional and national government. But Barranquita's mayor says he rescinded the permit granted by his predecessor, while the regional government has fired the official who granted permission.

Part of the problem in San Martín is that fewer than half of landowners have titles proving their ownership. Mr Fasanando says that this ambiguity encourages land grabs, migration and deforestation. Previous governments have fitfully undertaken titling programmes, inspired by Hernando de Soto, a Peruvian economist who argues that enforceable property rights are the key to development. But titles have mainly been given out in the cities.

A law approved last month seems to encourage landgrabbing. It legalises squatter settlements set up on private land before 2005—the eighth such measure in the past four decades. The law allows the compulsory purchase of such lands by the government. Another new law does the same for squatters on public land. More than 250,000 properties are involved.

Mainly because it welcomes investors, Peru's economy has grown strongly, more than doubling in size since 1993. According to several forecasters, it is the only one among the larger Latin American economies that will grow this year. But growth has gone hand-in-hand with protests, especially in the interior of the country. Sorting out land rights might bring harmony to the Peruvian cacophony.

Chile, Cuba and Latin America

Courting Castro

Mar 19th 2009 | SANTIAGO
From The Economist print edition

With uncertain benefit

CHILEAN officials like to compare their country to Finland and New Zealand, rather than its South American neighbours. The centre-left governments that have ruled since 1990 have signed free-trade agreements with half the world. To address fears of becoming isolated from a sometimes unstable neighbourhood, Michelle Bachelet, the current socialist president, has stressed closer ties with Latin America. Last month that tendency took her to Cuba.

Many Chileans were unhappy about this. But more than the smiling photos with Raúl and Fidel Castro, what turned the trip into a public-relations disaster was that Fidel chose the moment of her visit to publish an article backing Bolivia's claim to recover its former coastline, lost to Chile in a 19th-century war.

The trip was dreamed up by Ms Bachelet's political advisers. It prompted Alejandro Foxley, the foreign minister, to resign this month. It also highlighted a wider dilemma. Almost all Latin American governments want an end to the pointless American trade embargo with Cuba, and want normal relations with the communist island. They sense an imminent political transition. So leaders have queued up to visit the Castros. But this engagement has so far brought no signs of liberation for Cuba's political prisoners, let alone any move towards democracy.

Political breakthrough in Pakistan

Sharif wins a battle

Mar 19th 2009 | LAHORE
From The Economist print edition

Politicians, generals and Western allies conspire—productively, for once

AP

IT WAS first-rate political theatre. As an angry crowd approached a police cordon outside the house of Pakistan's opposition leader, Nawaz Sharif, the "Lion of Punjab", on March 15th, the police melted like spring snow. They were believed to have detained Mr Sharif in his house that morning, and had arrested dozens of his supporters outside it. Yet they were loyal Punjabis and Mr Sharif, a two-time former prime minister, is Punjab's man. With a roar of sports-utility vehicles, he and his companions emerged from their den, surged through the barricades and were free.

Entering central Lahore, Punjab's capital, Mr Sharif's cavalcade drew thousands, many waving the Islamic green flag of his Pakistan Muslim League (Nawaz) party, or PML (N). A few policemen, who had earlier lobbed tear-gas canisters at the throng, joined it. Speaking through a loud-hailer from the back of his blast-proof Toyota Landcruiser (a gift from Saudi Arabia's King), Mr Sharif declared that a revolution had begun. Leading a convoy of flash off-roaders, followed by tin-can hatchbacks, then autorickshaws and scooters, he surged on to Islamabad, 300km (185 miles) away, where a hapless autocrat, President Asif Zardari, was quaking.

Just after midnight, news broke that Mr Zardari's prime minister, Yusuf Raza Gilani, had an announcement to make. The autocrat had blinked, though six hours elapsed before Mr Gilani's televised speech. He declared that Iftikhar Chaudhry, a chief justice sacked by the former president, Pervez Musharraf, in 2007 and since championed by Mr Sharif, would be reinstated on March 21st. Mr Sharif and his supporters went home in triumph.

He would have been expecting this. Though not precisely scripted, this drama had been plotted during ten days of fraught negotiations between Mr Zardari, Mr Sharif and the army chief, General Ashfaq Kayani, with America and Britain mediating. In a country with little history of political compromise, all deserve praise for this, even Mr Zardari, who had provoked the crisis by leaning on the Supreme Court, which last month barred Mr Sharif and his brother, Shahbaz, from holding public office, and then by disbanding their government in Punjab.

The political fallout is also worth celebrating. Mr Zardari, the unpopular president of a country he is alleged to have looted, has been reduced. With Mr Chaudhry, a dream of judicial independence in Pakistan has been restored. Mr Sharif, a populist and conservative leader, shunned by Pakistan's and America's

previous administrations, is now talking to everyone and, confident of winning power at Pakistan's next election, is apparently happy to play by the rules. To encourage him—and as a precursor to Mr Zardari's cave-in over Mr Chaudhry—Mr Gilani has announced that the government will ask the Supreme Court to review its judgment against the Sharif brothers. In fact Mr Gilani, and the parliamentary system he represents, is another winner. Mr Zardari's humbling should make it likelier that he will now, as he has long promised, hand back some of the souped-up presidential powers he inherited from Mr Musharraf.

Though chastened by their leader's disgrace, some senior figures in Mr Zardari's Pakistan People's Party (PPP) are also quietly content. Mr Zardari, widower of Benazir Bhutto, a former prime minister, has become a clownish regent for her dynasty, dismaying a party that sees itself as Pakistan's most liberal and democratic. The recent resignation of two PPP ministers once close to Miss Bhutto, Raza Rabbani and Sherry Rehman, hinted at this. Ms Rehman, the information minister, quit last week after television news channels were taken off air by the de facto interior minister, Rehman Malik—one of several unelected cronies through whom Mr Zardari has been misruling his crisis-stricken country.

Promising more grown-up government, Mr Gilani this week vowed to enact the "charter of democracy", a blueprint for depoliticising Pakistan's institutions, including the judiciary, and reducing the army's political sway, which Miss Bhutto and Mr Sharif hashed out while in exile in 2006. On March 17th the prime minister even hinted that an alliance between the PPP and PML (N), formed after they crushed Mr Musharraf's supporters in an election last year and then wrecked after Mr Zardari broke a promise to reinstate Mr Chaudhry, could be refreshed. That seems unlikely. Yet Pakistan's leaders do have a second chance to make this government work. The need could scarcely be greater. A suicide-bombing in Rawalpindi on March 16th, farther along the planned route of Mr Sharif's aborted procession, served as a reminder of a thriving jihadist threat.

Alas, public need has never inspired Pakistani politicians to stop their feuding. Mr Chaudhry, a maverick judge who won little praise before his belated effort to stand up to Mr Musharraf, may provide grounds for more. He was sacked by the former army dictator, under cover of a state of emergency, because he appeared set to declare unconstitutional both Mr Musharraf's impending re-election as president, and an amnesty from corruption charges for Miss Bhutto and Mr Zardari. That is why Mr Zardari and the army were loth to have Mr Chaudhry back.

Allies of the judge say he will not reopen these controversies. Yet opponents of the government and army, including Imran Khan, a cricketer-turned-politician, are now lining up to petition his court to do so. If even somewhat independent, the judges might be hard-pressed not to rule that, for example, Mr Musharraf seized power illegally (twice) and that Mr Zardari should stand trial for gross corruption the instant he loses presidential immunity. To avoid the crises that would ensue, parliament, led by Mr Sharif and Mr Zardari, may now have to enshrine Mr Musharraf's legally-dubious legacy in the constitution. This would probably be part of a package of constitutional reforms, including some that Miss Bhutto and Mr Sharif envisaged—for example, to lift a ban on third-term prime ministers and to scrap the president's power to sack the government.

This is a lot to hope for. Mr Sharif hates Mr Musharraf, the coupster who ousted him, and has a reputation for vengeance. And Mr Zardari and Mr Sharif mistrust each other utterly. At least the army, as well as America, seems for once intent on holding the politicians fairly to account. From painful history, Mr Sharif knows the price of disappointing it. Mr Zardari should now know it, too.

Hong Kong and Macau

No politics, please

Mar 19th 2009 | HONG KONG
From The Economist print edition

Macau sails through a test Hong Kong flunked in 2003

MANY people visit Macau in search of sinful things to do. The tiny city next door to Hong Kong is Asia's capital of gambling and decadent fun. However, Johannes Chan, dean of the University of Hong Kong's law faculty, visiting for a far more austere purpose, found the self-governing Chinese enclave less than hospitable. On February 27th he took the one-hour hydrofoil ride to give a lecture at a university. But he was turned away on arrival, when an immigration official found his name on a list of banned visitors. Mr Chan is not alone. In the past year Macau has denied entry to several other potentially bothersome visitors from Hong Kong, including a pro-Tibet student activist, a press photographer and members of its Legislative Council.

Disturbed by what looks like politically motivated discrimination, 33 pro-democracy Hong Kong legislators and activists crossed the sea on March 15th to force a showdown. The Macau authorities promptly put five of them on a return ferry, citing internal-security reasons. The others were allowed to deliver a letter of protest to the Macau government.

This failed to mollify Macau's critics. Under pressure from its own legislators, Hong Kong's government has conveyed "concern" to Macau's. For its part, Macau says it values exchanges with Hong Kong but reserves the right to deny entry to anyone. Lau Nai-keung, a Hong Kong member of China's National People's Congress, adds that because of Macau's reliance on tourism, its low tolerance for troublemakers is understandable.

One reason for Macau's jitters about any hint of unrest may be economic. The downturn has reduced tourist arrivals. Throughout 2008 Macau also saw waves of lay-offs, as casino developers struggled with a cash squeeze. The government is worried about labour discontent. Two years ago, on May Day, local residents staged violent protests against the gaming industry's employment of foreigners. Indeed, one of the Hong Kong legislators turned away on March 15th is general secretary of an umbrella union group.

Illustration by Claudio Munoz

Politics, however, seems the bigger issue. Mr Chan suspects that Macau blacklisted him for his role in a group in Hong Kong that in 2003 lobbied against a national-security law, which the government in Beijing wanted Hong Kong to adopt. Many thought the sweeping but vague language banning sedition in the so-called "Article 23" legislation a threat to Hong Kong's open society. Huge street protests forced the government to shelve it indefinitely. But just two days before Mr Chan's trip, Macau passed its own version of the law, without a peep from its less-politicised public.

Pro-democracy activists in Hong Kong fear Macau's tighter border controls reflect the new post-Article 23 reality. Worse, they see a glimpse of Hong Kong's repressive future, should the government make a renewed push to pass the legislation and succeed. China's role in the brouhaha, if any, is unclear. It no doubt considers Macau an obedient child. But if its zeal to please its parent antagonises its bigger sibling, even China may be unhappy. For now, people of all political leanings are urging Macau and Hong Kong to patch things up on their own.

A Chinese eco-city

City of dreams

Mar 19th 2009 | DONGTAN
From The Economist print edition

Still on the drawing-board

IDEAS about tackling China's myriad environmental woes, from soil erosion to polluted waterways, tend to come in outsize packages—hardly surprising, given the scale of the damage. Bold environmental solutions are as appealing to policymakers as they are to engineers who want to put their stamp on the cities of tomorrow. One such project is Dongtan, a planned eco-city on an alluvial island near Shanghai. Designed by Arup, a British design firm, to house 500,000 people on a 8,600-hectare (21,250-acre) site, it was billed as a low-carbon alternative to urban sprawl and a blueprint for other eco-cities. But four years on, not a single green building has gone up on the site.

The reason lies not in the spluttering global economy but in the political corridors of Shanghai, the powerful city to which Chongming island belongs. A prime mover behind Dongtan was a former Shanghai Communist Party chief, Chen Liangyu, who steered the land into the hands of Shanghai Industrial Investment Corporation, or SIIC, a state-owned developer, and lent his prestige to the project. Then, in 2006, Mr Chen was sacked for property-related corruption. He was later convicted and is under house arrest. The way big land deals are done in Shanghai has been changed.

A noticeable loser is Dongtan. Arup's original plan had 50,000 residents moving in by 2010, when Shanghai hosts the World Expo. That has now been quietly dropped. Arup's Roger Wood says SIIC has opted to put construction on hold, pending further permits. He denies, however, that the project has been cancelled. On a recent visit to the site, your correspondent found an SIIC business centre and a shuttered hotel, neither of which appear in the master plan. Local residents say the hotel, outside the site proper, was a private villa owned by Mr Chen, who presumably enjoyed his excursions to Chongming.

A new bridge and tunnel spanning the estuary is already completed and will open to traffic later this year. That should boost land prices on Chongming, and may give SIIC a nudge to develop—or sell—the Dongtan site. It also raises the question, however, of what constitutes an eco-city. Arup had envisaged a compact, mostly car-free community. Residents would live and work in green research centres and other such industries, buy local produce and use renewable energy. The new road link, however, puts Shanghai within commuting distance. Locals also talk excitedly of future sales of holiday and retirement homes—hardly the original idea. Critics also point out that building an eco-city on farms near hugely important wetlands, which attract rare migrating birds (and birdwatchers), was always dubious. For its part, Arup said the wetlands would be protected by a buffer zone around the city.

A more obvious strategy might seem to be to rebuild a polluted industrial zone in China's rustbelt and insist on smart design and energy efficiency. But China is urbanising so relentlessly that vast tracts of housing will have to be built somewhere. By 2030, the urban population is forecast to reach 1 billion, according to McKinsey Global Institute. Better to plan new, more efficient cities than allow car-dependent urban sprawl to eat up farmland around existing urban centres, goes the thinking. Better still, of course, to build them.

Opium in the Golden Triangle

Golden days

Mar 19th 2009 | LUANG NAM THA
From The Economist print edition

The hills are alive with poppies again

IN THE remote mountains of northern Laos, a profusion of red and white poppies is once more in evidence, in defiance of a strict government ban on opium cultivation, in force since 2002. Hill-tribe farmers in Luang Nam Tha province, after several hungry years without their traditional cash crop, have smiles on their faces again. The same pattern can be observed in other provinces, such as Houaphan, where in one district alone poppies are blooming in eight out of 11 villages. Farm-gate prices for opium have soared to $1,400 a kilo as other commodity prices have tumbled. So there is plenty to smile about.

America and the United Nations Office on Drugs and Crime (UNODC) had pushed the communist rulers of this poor landlocked nation into a crackdown on opium cultivation. In 2006 UNODC's head, Antonio Maria Costa, triumphantly reported that after three years of eradication Laos, which used to produce about 100 tonnes of opium a year, was now, like Thailand, officially opium-free.

Even the third side of the infamous Golden Triangle, Myanmar, was reported to have made huge reductions in poppy-growing. So in 2006 Mr Costa could dream that the whole area might move towards eradication. Three years later, however, progress is looking tenuous. UNODC's office in Bangkok last month released the results of its 2008 opium survey, conceding an alarming resurgence in the region.

In the Wa region of northern Burma, farmers have been calling on local authorities to allow a return to poppy-growing, which was suspended almost three years ago. Some have shifted their cultivation to other parts in the Shan states. With prices for tea and rubber falling by 50% in that period, UNODC officials note the huge temptation for farmers to revert to opium, the price of which has doubled. Afghanistan is still the world's biggest producer of illicit opium, far ahead of Myanmar's estimated 410 tonnes in 2008. But output in the Golden Triangle is expected to rise sharply in the coming year.

Despite all the promises of development, and the promotion of other crops such as tea, asparagus and rubber, switching out of poppies had left most farmers in Myanmar and Laos worse off, even before the current global downturn. UNODC and the Laotian government had to appeal to the World Food Programme (WFP) for emergency food aid. More than half the 2,058 villages in the provinces of Phongsaly, Houaphan and Xieng Khouang, most of which had been put under pressure to abandon opium, were short of food. A former WFP representative in Vientiane, Christa Rader, concludes that massive development programmes will be needed to help former opium-growers find other ways of making ends meet.

However, although an opium revival may be inevitable, it may not automatically lead to a big increase in heroin trafficking. Anthropologists working in Laos note that the crop is mostly used to pay for food, household needs and as a medicine for pains, coughs and stomach complaints.

Burmese migrant workers in Thailand

Myanmar's overflow

Mar 19th 2009 | MAE SOT
From The Economist print edition

Migrant workers battered by the slump

MORE than 1m people from Myanmar have opted to labour in the sweatshops, fields and fisheries of Thailand rather than endure the daily struggle for survival many face at home. The global downturn has conspired to make their prospects, never rosy, even bleaker.

An estimated 120,000 migrant workers live in the Thai border town of Mae Sot. Most work in garment factories, seen as the best of a few bad choices. Others have to take dirty and dangerous jobs processing fish or spraying crops, where abuses, including beating and enslavement, are reportedly most common. Garment-workers say they typically take home about 70 baht ($2) a day, less than half the legal minimum wage. They dispute employers' claims that the discrepancy reflects the cost of food and lodging.

Some workers, particularly from minority ethnic groups, are fleeing persecution. One young woman, stitching baby clothes, is saving to pay for a physics course at Yangon University. But most workers are in Thailand to support families at home. According to Sean Turnell, a specialist on Myanmar's economy at Macquarie University in Australia, the average worker sends back around $300 a year, a crucial prop for hundreds of thousands of poor families.

The downturn was quick to hit Mae Sot's export-focused garment factories. According to Chaiyuth Seneetantikul, of the local chapter of the Federation of Thai Industries, orders are down by only around 12% and redundancies have been minimal. But many workers say that production has dwindled; the talk is of lay-offs, unpaid leave and the cancelling of overtime, on which most rely to make any savings.

The value of their remittances has been further eroded by the appreciation of Myanmar's currency, the kyat. It has risen by a quarter against the baht over the past year, mostly, says Mr Turnell, because of inflows of aid after Cyclone Nargis. The appreciation has been exacerbated by falling demand for imports inside Myanmar, a symptom of a slumping economy.

The plight of migrant workers in Thailand is worsened by the unregistered and hence illegal status of at least half of them. This makes them vulnerable to exploitation by employers, frequent extortion by the police and periodic clampdowns. Migrant workers have been quietly encouraged, but no new registrations have been accepted since 2006. In January, when his government was under pressure over the army's callous treatment of ethnic-Rohingya boat people, originally from Myanmar, Abhisit Vejjajiva, the prime minister, told journalists that the illegal-immigrant problem had to be solved. "We will push them out of the country," he blustered.

According to activists in Mae Sot, the next three days witnessed the rounding up and expulsion of 1,500 migrant workers. Most reportedly came straight back across the open border. There may be more such incidents as the Thai economy worsens. But the impact of the slump on migrant labour may not be straightforward. Garment-workers will doubtless continue to feel the pinch and suffer redundancy and lost income. But those toiling in dirty and dangerous jobs may still be in demand, even as prices and incomes fall. Cheap labour is rarely scorned in a downturn.

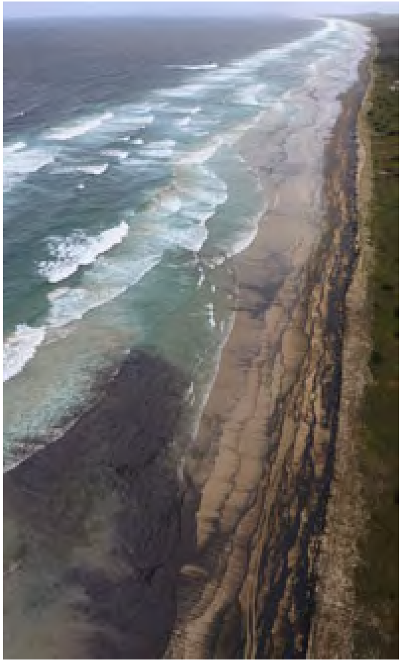
An oil spill off Queensland

The Sludge Coast

Mar 19th 2009 | BRISBANE
From The Economist print edition

A disaster for the environment, for tourism and for an election campaign

EPA



It makes you slick

THE beaches near Brisbane are usually among the world's most pristine, helping to generate tourism revenue of about A$1.3 billion ($850m) a year for Queensland's capital and Australia's third-largest city. But more than a week after oil gushed from a cargo ship off the city's shoreline, many were still covered in black sludge. Apart from turning into one of Australia's worst environmental disasters, the spillage swamped a state election campaign in Queensland where the economic policies of Kevin Rudd, the prime minister, were under scrutiny.

The spill happened on March 11th when the *Pacific Adventurer*, registered in Hong Kong, sailed into heavy seas whipped up by Cyclone Hamish. Her cargo of containers of ammonium nitrate fertiliser rolled overboard, puncturing the ship and releasing oil. At first Swire Shipping, the owner, thought the leak was small. Australian authorities later estimated it at 250,000 litres. Some oil reached beaches 60km (37.5 miles) north of Brisbane along the Sunshine Coast, a tourist playground and one of Australia's fastest-growing regions. Moreton, a sandy island off Brisbane much prized by ecotourists, has had to contend with oil washing up on its beaches and beating against its cliffs.

It was Australia's third environmental disaster in a matter of weeks. In February bushfires ravaged Victoria, leaving at least 210 people dead, and floods swamped north Queensland. Peter Newman, a professor of sustainability and an adviser on adapting Australian cities for global warming, links all three calamities to changing climate patterns. "A hurricane causing an oil spillage is a symbol of the future we're trying to avoid," he says.

The disaster also blighted the re-election campaign of Anna Bligh, Queensland's premier for the past 18 months. Voting is due on March 21st. Campbell Newman, Brisbane's conservative mayor, accused the 11-year-old state Labor government of acting too slowly to clean up the mess. Hundreds of workers with rakes and spades fanned across beaches to dump oil-soaked sand into plastic bags. The job is unlikely to be finished until Easter.

Mr Rudd, a Queenslander himself, flew to Brisbane to campaign for his fellow Labor leader. Alluding not to the oil spillage, but to his bid to boost Australia's flagging economy before it happened, he promised to help Ms Bligh "steer Queensland through the stormy economic seas that lie ahead". Keeping Labor support steady in his home state will be vital for his own fortunes long after the beaches are pristine again.

Iran's presidential choice

It could make a big difference

Mar 19th 2009 | TEHRAN
From The Economist print edition

The coming election in Iran could change the region drastically, for better or worse

Reuters

AS PICTURED by its leaders, Iran is striding from strength to strength. The Islamic Revolution that 30 years ago toppled the shah continues to defy the country's foes, uplift its people and uphold its founding principles. Not only has it made big strides in nuclear technology. Last month it further confounded naysayers by launching a sophisticated rocket bearing its very own small satellite, *Safir Omid*, or *Ambassador Hope*, into orbit. Iran must now, declared its ebullient president, Mahmoud Ahmadinejad, be ranked a superpower.

A text message that flashed onto Iranian mobile phones soon after the space shot suggested a different narrative. "First finding from Omid: earth is round!" read the lighthearted gibe at what many Iranians stubbornly bemoan as the provincial backwardness of their rulers. The revolution may have brought gains in public health, education and rural electrification, among other things. Its survival against often difficult odds, plus those symbolic feats of technical wizardry, do bolster national pride even among grudging secularists. But to a large number of Iran's people, it has all come at a painful price.

This is easily measurable in terms of lost economic opportunities, fraught foreign relations and increasingly curtailed freedoms. Harder to measure is the cost in morale brought by a deep weariness with imposed pieties. Not only has this helped to push as many as 2m Iranians into dependence on the cheap drugs that pour in from neighbouring Afghanistan, and to perpetuate a crippling drain of talent through emigration. It also casts a pervasive veil of melancholy over life in general. That jocular text message, for instance, provoked killjoy security officials to give warning that senders of such subversive stuff may in future be hunted down and prosecuted.

The divergence between these world views has become more evident as Iran approaches presidential elections due in early June. The contest is likely to be bruising. Despite the abrupt withdrawal from the race of a leading reformist, the former president, Muhammad Khatami, the range of remaining contestants represents a striking diversity of interest groups and social classes. With the politicking already growing shrill, the next hundred days promise to be unusually rowdy by the normally polite, albeit quietly cut-throat, standards of Iranian politics.

It is true that the democratic elements of Iran's peculiar system, which seeks to represent both God and

man, are tightly constrained. Candidates must be vetted by a Council of Guardians, made up of senior clerics, which is empowered to reject anyone who doubts the revolution's Islamic tenets. One of these is *velayet el-faqih*, a controversial doctrine, unique to Iran, that exalts the power of the supreme leader, or *rahbar*, an anointed cleric, over the people's elected representatives. This makes Iran's presidents in effect subservient, particularly in foreign policy and specifically on the nuclear issue, to the will of Ayatollah Ali Khamenei, who has held the *rahbar*'s office since the death of his predecessor, Ayatollah Ruhollah Khomeini, in 1989.

Such restraints are not the only ones that will curb the powers of Iran's next president. A potentially severe economic crisis also looms. This comes as a direct result of the collapse in prices for Iran's main export, crude oil, but has been worsened both by four years of Mr Ahmadinejad's recklessly spendthrift policies and by UN and other sanctions, intended to punish Iran for seeking a potentially offensive nuclear capability, which have throttled trade and stunted foreign investment.

But where's the cash?

With the budget deficit ballooning, whoever rules the country will be forced to take unpopular measures such as slashing ruinous state subsidies. Among other effects, this has kept the petrol price below a trifling ten American cents a litre, even though Iran, since it has failed to invest in refining, actually imports a lot of its fuel.

Even cynical observers concur that this election will be unusually important, and not just for Iran. "This could prove the most significant poll so far since the revolution," says a consultant to one conservative candidate. "I'd say it ranks in significance on a global scale with November's American election." A grandiose claim, perhaps. Yet it is true that, depending on the cleanness of the process and, vitally, on the scale of voter turnout, what may be at stake is nothing less than Iran's nature as a closed or relatively open society.

This carries implications that go beyond the borders of this large, ancient nation that is one of the few to proclaim its open defiance of the American-dominated world order. Iran's election will certainly affect the immediate region, replete with Iraq's continuing unrest, Afghanistan and Israel-Palestine; Iran's leadership has proved amply capable of exacerbating trouble in all those places. The trajectory taken by Iran can also influence the wider Muslim world. The country's unique experiment has the potential to set an example of peaceful transition and reform. But if hardliners insist on trying to export their revolutionary ways, tension could worsen between the Sunni majority of the world's Muslims and the Shia minority, many of whom look to predominantly Shia Iran as their champion.

A fresh mandate for Mr Ahmadinejad would, say his critics, consecrate the "revolution within a revolution" he has been trying to effect since his surprise electoral triumph in 2005. Best known to outsiders for his bellicose grandstanding, the incumbent is more familiar to Iranians as a radical and hyperactive populist who has used the tacit backing of his fellow conservative, Mr Khamenei, greatly to expand the powers of the presidency.

How the Satan-baiter plans to hold on

Determined to reignite revolutionary fervour, Mr Ahmadinejad has purged numerous suspected liberals from universities, the diplomatic service and senior government posts, replacing them with like-minded ideologues. His reinforcement of chafing restrictions on civic freedoms has sent scores of dissidents to prison, including students, labour organisers and feminists demanding equal rights, along with representatives of minority groups, such as followers of the Bahai faith. It has brought back the ugly spectre of police cruising city streets to harass and humiliate women they deem to be immodest in their dress.

The president's open-handed economic policies, based on a windfall of $250 billion in oil sales during his four-year term and intended to redistribute wealth, have won friends among the poor. Mr Ahmadinejad has tirelessly toured Iran's impoverished and neglected remoter provinces, snipping ribbons, laying foundation stones and fielding petitions from clamouring crowds, with flattering television cameras perpetually in tow.

But his gleeful emptying of state coffers has also made inflation surge. The current rate is 26%, though

falling. Iranians, particularly the urban young who are products of a baby-boom in the 1980s, have yet to recover from the shock of house prices tripling since 2005. Meanwhile, such dubious initiatives as forcing banks to slash interest rates and lavishing giant contracts on such ideologically orthodox but questionably competent institutions as the Revolutionary Guards have brought cries of foul from most economists.

Like voters nearly everywhere, Iranians tend to put domestic issues ahead of foreign policy. Even so, the style in which Mr Ahmadinejad conducts himself sparks broad controversy. Critics charge that Iran's continuing diplomatic isolation is largely because of his unnecessary abrasiveness. But his admirers say his theatrical defiance has in fact raised Iran's prestige, forcing its foes to address the country on its own terms. As proof of Iran's ascendancy, they point to America's costly quagmire in Iraq and to Israel's failure to crush either Hizbullah or Hamas, Iran's staunch ideological allies in Lebanon and Palestine respectively, which have benefited from its paternal largesse.

An electoral victory for Mr Ahmadinejad would serve to bolster Iran's posturing as the great defender of the world's underdogs. This might not exclude a turn to pragmatism. Iranian officials have signalled repeatedly that, given friendlier moves by America, they may not be averse to co-operating on some issues with Barack Obama's administration. But a continuation of Iran's hostile stance under Mr Ahmadinejad would multiply potential diplomatic pitfalls and almost certainly slow down efforts to coax Iran into behaving as a more responsible global citizen.

Reuters

The supreme leader approves of the people's president—so far

A convincing electoral triumph for one of Mr Ahmadinejad's challengers from the reformist camp, which struggled to liberalise Iran during Mr Khatami's presidency from 1997 to 2005, could produce a very different result. Wary of the ever-vigilant supreme leader and chastened by past failures to overcome conservatives, who now control the elected legislature as well as such pillars of Iran's "deep state" as the security services, courts and state broadcasting monopoly, a reformist president would probably shy away from any bold departures in foreign policy. Yet even changes in tone could have a dramatic effect.

Certainly there are fixed parts of Iranian policy that bother its neighbours, such as its nuclear ambitions, its determination to oust the American forces which smaller countries in the region think they need as guarantors of their freedom, and its hostility to the idea of a negotiated Arab-Israeli peace. Yet important shared aims exist on other issues. Iran would prefer to see stable governments in Afghanistan and Iraq. It wants to help fight the drug trade. It sorely needs foreign money and know-how to produce more energy. Iran's vast reserves of natural gas make it a natural alternative to Russia for energy-thirsty Europe.

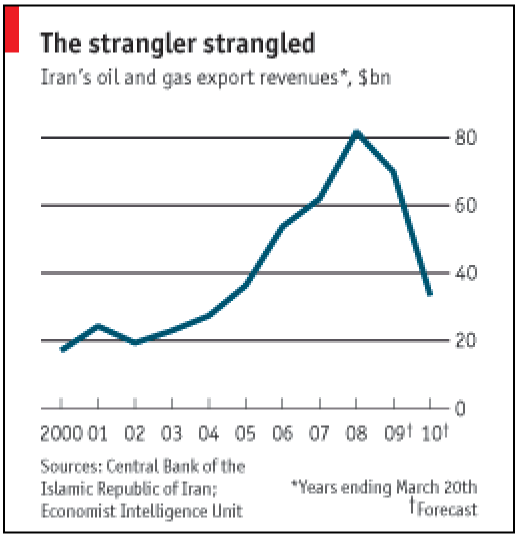
Change the mood, then

Arguably, what has prevented a meeting of minds on such matters is not the pursuit of actual national interests by Iran or its adversaries, but an attitude of mutual mistrust sometimes amounting to paranoia. Both Mr Ahmadinejad and his mentor, Mr Khamenei, share this attitude in spades. So do many Iranians, based on a reading of history that portrays Iran as a serial victim of foreign plotting. There is, indeed, no lack of evidence for such past devilry, ranging from British and American sponsorship of the coup against Muhammad Mossadegh in 1953 that ended a brief experiment in democracy, to Western backing for Iraq during its 1980-88 war against Iran (when around a million people in all were killed), to America's more

recent broadening of its regional military bootprint across an array of countries that ring Iran.

More sophisticated Iranians, including some conservatives, understand that adopting a hectoring tone with the West, or endlessly castigating Israel, does little to advance Iran's interests. "There is no reason for us to consider that all the world is our enemy," says Muhammad al-Abtahi, a former vice-president under Mr Khatami. Mr Abtahi chastises those Iranians who, he says, prefer to stay hostile to America just so they can pose as leaders of global opposition to the Great Satan; Iran has far more to gain than lose by dialogue. "On the nuclear issue, for instance, we believe that through dialogue we can have our rights [to nuclear technology] while also winning the world's trust. There has been nothing useful in getting three UN Security Council resolutions against us."

Mr Abtahi and his allies know that conservatives would not hesitate to frustrate the aims of the reformists if they were to regain the presidency. At best, the reformists would hope to undo some of Mr Ahmadinejad's more destructive policies by, for instance, making public accounts more open and bringing a higher calibre of people into government. More important, they believe, a convincing majority for the reformists, built on a large voter turnout, could help shift some power back from theocratic bodies to elected institutions. "For me, the most important thing is to remove the pessimistic atmosphere in society, to make people feel they can have some effect on their destiny," says Issa Saharkhiz, a prominent editor who, with scores of journalists, has been hounded out of work by the serial closure of reformist publications.



If the playing field were even, the reformists would have a good chance of returning to office. Before his withdrawal, unofficial opinion polls suggested that Mr Khatami was more popular than Mr Ahmadinejad. But the reformists face numerous and treacherous obstacles. More careful polling, for instance, revealed that, among Iranians declaring their intention to vote, the incumbent would win handily. This reflects chronic disillusion in the reformists' natural constituency, Iran's large and educated urban middle class. In the capital, Tehran, turnout in recent elections has rarely exceeded 30%, half the level in the rural regions where Mr Ahmadinejad is most popular.

Because Iran has no coherent political parties and therefore no primary elections, the reformists face another big problem. Many recall their debacle in the presidential elections of 2005, when multiple reformist candidates split the vote in the first round, letting the then widely derided figure of Mr Ahmadinejad leapfrog into a second-round run-off. Mr Khatami says he withdrew from the current race to prevent this from happening again. But his departure leaves two powerful reformist rivals in the running.

Will they split the vote again?

Mehdi Karroubi, a former speaker of parliament and a senior cleric with a wide following among some ethnic minorities, says he is determined to stay in the race to the bitter end. He made a respectable showing in the 2005 election, gaining notoriety with a promise to pay cash handouts from oil revenues to every citizen.

His reformist rival, Mir Hosein Mousavi, a popular prime minister during the war with Iraq, may also mount a strong challenge. His reputation for toughness and probity could appeal to conservatives as well as reformists. Yet precisely because they are seen as closer to Iran's revolutionary establishment than Mr Khatami is, neither of the two rivals is as likely to inspire the crucial constituency of fence-sitting sceptics to bother to vote.

Another challenge confronts the reformists. Iran's "deep state", increasingly bold under Mr Ahmadinejad, has made little effort to disguise its determination to block their return to power. The supreme leader, a skilled dispenser of razor-sharp innuendo despite feigning distance from the political fray, has consistently signalled support for the ruling camp. More bluntly, powerful chiefs in the army and Revolutionary Guards have stated their preference for the incumbent, while giving warning of the danger of a "velvet revolution" in the guise of reformism. State radio and television, which are under Mr Khamenei's control, give blanket coverage to Mr Ahmadinejad, while largely ignoring his opponents. Nor

will reformist candidates risk being shown on the BBC's recently launched and widely praised Persian satellite-television service, since security officials have declared that people co-operating with such enemy propaganda could be liable for prosecution.

Iranians remain uncomfortably aware that the Ansar-e-Hizbullah, a semi-official vigilante group, has in the past been accused of murdering reformists. Such shadowy groups, plus organisations more openly loyal to the supreme leader such as the Revolutionary Guards, veterans' clubs and the *Basij*, an auxiliary force of youthful zealots with branches in mosques, schools and universities, are also known for more peaceful political work. In many cases, such groups actually run the polling stations. Not surprisingly, their mobilisation is widely credited with securing Mr Ahmadinejad's surprise victory in 2005, which brought credible charges, from Mr Karroubi among others, of electoral fiddling in some districts.

Yet it is not entirely clear whether such cats'-paws will be put to the same uses. While many Iranians shrug that Mr Ahmadinejad's return is a foregone conclusion, others point to the often severe criticism he has endured from fellow conservatives. Mr Ahmadinejad has, in fact, yet to declare himself formally as a candidate.

One powerful potential alternative, reputed to be close to the supreme leader, is Tehran's efficient and pragmatic mayor, Muhammad Qalibaf. A distinguished war veteran and widely praised former chief of police, he has said that he would welcome dialogue with America and believes Iran can defend its principles at a lower cost than it currently pays.

Many conservatives, alarmed by the president's erratic policy and language, would prefer to see a more polished and experienced administrator in power. Some suggest it would be useful for Iran to present a new face to the world, even if it keeps the uncompromising foreign policy it has had under Mr Ahmadinejad. And even some reformists believe that, while anyone would be better than the incumbent president, it may be shrewder to back a conservative who might fulfil his promises rather than a reformist who very well might not.

Burkina Faso's president

A canny chameleon

Mar 19th 2009 | OUAGADOUGOU
From The Economist print edition

How Blaise Compaoré stays on—and on

AFP

AFTER overthrowing his close friend in a bloody coup d'état, Burkina Faso's captain-turned-president, Blaise Compaoré, has held power for more than two decades. He was often accused of ruling with an iron fist and sponsoring rebellions all over west Africa. But nowadays Beau Blaise portrays himself as a respected statesman who can soothe rather than stir things up.

He was a key man in the coup that brought Thomas Sankara to power in 1983. Four years later, Mr Sankara was killed, perhaps after he told soldiers loyal to him to eliminate his supposed ally. Mr Compaoré, then 36, took over one of the world's poorest countries.

He soon won a reputation for making trouble in the region. UN reports accused him of backing Charles Taylor's rebels in Liberia, during a civil war that spilled over bloodily into neighbouring Sierra Leone. "Burkina Faso is landlocked and impoverished, so he had an eye to make money… through diamonds and so on," says Richard Moncrieff of the International Crisis Group (ICG), which tries to solve conflicts. In 2002 Mr Compaoré was also accused of funding rebels who seized the north of Côte d'Ivoire, where as many as 3m people from Burkina Faso live; the rebels had plotted and trained in their original homeland.

But in the past two years Mr Compaoré has become more conciliatory. He has mediated not only in Côte d'Ivoire but also in Togo and Niger. His new approach has benefited Burkina Faso. "Burkina and Côte d'Ivoire are like two legs of one person," says his government spokesman. "If we don't help the sub-region, it will never develop. Togo, like Côte d'Ivoire, is a place where we can have access to the sea."

Mr Compaoré's officials praise him for bringing in multi-party politics in 1991, under pressure from foreign donors and in particular from France. The opposition boycotted the polls on several occasions. Elections are due next year. Mr Compaoré is almost sure to win what should, according to the constitution, be his final term.

But many doubt he will leave office in 2015, when he is meant to. "He's a soldier, so he thinks strategically," says a human-rights campaigner in Ouagadougou, the capital. "The rules of the game aren't fair… Blaise Compaoré has money, the army, the administration and the powerful traditional chiefs. The opposition is weak because he has corrupted it."

Despite a shady past and shaky democratic credentials, Mr Compaoré has won a certain authority thanks to his longevity in office. He has chaired the Organisation of African Unity (the African Union's forerunner) and the Economic Community of West African States, better known as ECOWAS. Though poor, Burkina Faso, formerly Upper Volta, seems stable and better governed than many of its neighbours. The ICG's regional man says Mr Compaoré is "the ultimate political survivor", a chameleon who has been "very good at catching the wind", sensing that his adventurous policies would not succeed for ever. And he has granted just enough democracy and exercised enough financial prudence to keep foreign donor governments sweet.

Dubai

A little more decorum, please

Mar 19th 2009
From The Economist print edition

The relatively liberal emirate tightens its rules against kissing in public

Illustration by David Simonds

THE image of Dubai as a sinfully glitzy oasis is fading, and not just because cash is less abundant in the global freeze. Belatedly concerned that its 1m-odd foreign residents, plus millions more tourists, are diluting its identity, the freewheeling emirate plans to curb their enthusiasm. A commission chaired by the crown prince, Sheikh Hamdan al-Maktoum, has proposed a code of public conduct to tighten strictures on dress, drinking, dancing and public displays of affection, such as kissing.

Not yet law, the code stresses tolerance and respect for diversity as cornerstones of Dubai's success. But it also stipulates that improper behaviour that flouts local customs may lead to fines, prosecution or deportation. This is neither new nor unexpected. Dubai's authorities recently jailed and deported a British couple caught having sex on a public beach, and have sentenced another Briton, a mother of two, to prison for adultery. Occasional morality campaigns have led to suspected homosexuals and cross-dressers being pestered, and may have dented the emirate's thriving prostitution trade.

Even if the proposed rules are enforced, confining dancers to enclosed places, drinkers to designated bars, swimsuit-wearers to beaches and would-be hand-holders to their legitimate spouses, Dubai will still look ragingly liberal compared with its neighbours. The current bestselling Arabic-language book in the emirate, for instance, is a sex-education manual by a family counsellor working in Dubai's courts. By contrast, religious police in the Saudi capital, Riyadh, patrolled the city's annual book fair earlier this month to prevent any hint of mingling between the sexes. Three Saudi writers complained that they were hustled off for interrogation after trying to get a novel signed by its female Saudi author.

In a much-heralded breakthrough, Saudi Arabia recently elevated a woman to the post of deputy minister of education. But she cannot drive a car and can communicate with her boss, the minister of education, only via closed-circuit television. Last week a Saudi judge sentenced a 75-year-old widow to four months in jail and 40 lashes for inviting two young men into her house. The errant youths, one of them a nephew of the woman's late husband, said they had simply been kind enough to bring the elderly lady some loaves of bread.

Madagascar

An odd way to change a government

Mar 19th 2009 | ANTANANARIVO
From The Economist print edition

How a president came to be ousted by a mayor

AP

All done quite legally, they say

IF IT was a coup, it was quite a strange one. On March 17th, just a few hours after declaring he would fight to the death rather than ever resign as Madagascar's president, Marc Ravalomanana announced he was stepping down, transferring all power to a hand-picked military triumvirate. But within hours that trio, all hitherto loyal to the president, were persuaded (after their arrest) to hand over that power to Andry Rajoelina, the popular young mayor of Antananarivo, the capital, with whom Mr Ravalomanana had been locked in a power struggle for three months. Not a shot, it seems, was fired in anger. The new man's people say everything, at a pinch, has taken place in a legal framework.

That puts foreign governments and international bodies in a quandary. Earlier, the African Union (AU) said it would never recognise a government that had come to power in a military coup; though the AU accepted one last year in Mauritania, African leaders remain wary of recognising violent seizures of power for fear it could be their turn next. The European Union, one of the biggest donors to this impoverished Indian Ocean island, had threatened to cut off aid to anyone who took power by force. Ban Ki-moon, the UN's secretary-general, had urged Madagascar's two rivals to sit down and sort things out.

The protagonists will argue over whether this was a coup. Madagascar's Constitutional Court has been quick to "validate" the transfer of power to Mr Rajoelina, who now, according to the court's nine judges, has "all the attributes of the republic's president outlined in the constitution", albeit only for a maximum of 24 months, the period within which the former mayor has promised to hold elections. The next presidential poll was anyway due by the end of 2011. The day before the court's ruling, Mr Rajoelina had declared himself "president of the transitional high authority", a title that seemed to fall short of "president of the republic".

Though the week's events, culminating in the president's fall, seem to have been bloodless, Antananarivo has been in turmoil for the past few months. From the moment that Mr Rajoelina, a former disc-jockey turned big businessman, beat the president's candidate in local elections in December 2007, Mr Ravalomanana, who had never lost an election since he had entered politics in 1999, was bent on undermining the capital's new mayor. Since his disputed election in 2001, the increasingly autocratic president had swept aside all serious opposition, amending the constitution to let himself stand for a third term.

But the more Mr Rajoelina came under attack, the more support he seemed to win. In December Mr Ravalomanana closed the mayor's popular television channel and radio station. In January Mr Rajoelina held the first of what became weekly protest rallies in the capital's main square, defying a ban on

demonstrations and demanding the president's resignation for "high treason". By the end of the month the protests, previously peaceful, had turned ugly. Rioters started to burn and loot, targeting especially anything linked to the president, who owns the island's biggest food group. At least 100 demonstrators were killed.

With everyone shocked, it looked as if the protests might fizzle out. But then, in early February, the president sacked Mr Rajoelina as mayor. A few days later thousands of his supporters marched on the presidential palace in the capital. The presidential guard opened fire, killing at least 28 people. Early this month security forces tried in vain to arrest Mr Rajoelina.

From then on, events unfolded with alarming and confusing speed. Some units of the army mutinied. The head of the armed forces gave the feuding leaders 72 hours to end an impasse that was deterring foreign investors and ruining the island's big tourist industry—or face military intervention. The next day, Colonel André Ndriarijaona, a dissident soldier at odds with the army chief, declared himself head of the armed forces amid reports that the rebels had started to bring tanks into the capital to prepare for a final assault.

Mayor culpa

Then, on March 14th, Mr Rajoelina emerged from hiding to declare that the president, the government and the leaders of both houses of parliament had been relieved of their duties; by whom or by what authority was unclear. Mr Ravalomanana countered with a proposal for a referendum, a cunning move since no one knows how much support Mr Rajoelina has outside the capital. Instead, the mayor issued a warrant for Mr Ravalomanana's arrest.

The noose was tightening around the president's neck. Several of his old allies had defected to Mr Rajoelina's camp. The civilian and military police had joined the mutinous soldiers. Mr Ravalomanana still had his 500-strong presidential guard, but it was unclear whether the rest of the army was loyal. The prime minister's office had already been seized by Mr Rajoelina's lot. Rebel soldiers stormed the presidential palace in the city centre. No one was killed; the presidential guard had fled. When the rebels moved in to take the president's country palace the next day, no one resisted. The president had gone. The coup—for it certainly looked like one—was over. A 34-year-old novice is in charge of a country of 20m more than twice the size of England.

Foreign governments and organisations are scratching their heads. Most of them do not want to look as if they are condoning what has been, at the least, a most irregular takeover. South Africa and Zambia sounded unhappy. The AU seemed hesitant. And Western donors, while reluctant to approve of the coup, do not want to abandon Madagascar's dirt-poor majority, who survive on less than $2 a day.

Ireland's economy

The party is definitely over

Mar 19th 2009 | DUBLIN
From The Economist print edition

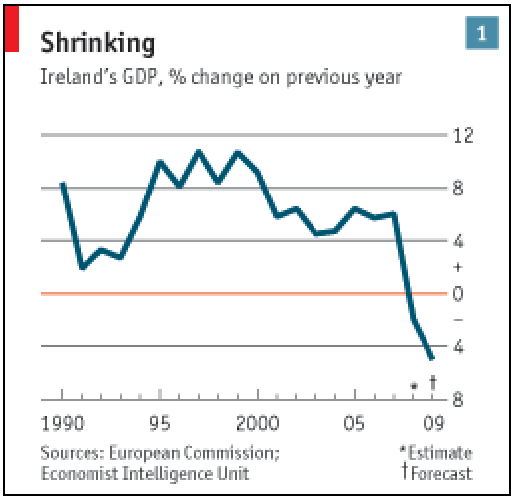
How wage cuts and tax rises might preserve the gains of Ireland's Celtic Tiger years

AFP

DUBLIN is full of shiny new office buildings and retail outlets. But many are unoccupied, monuments to a construction boom that went bust. At one site, the football ground at Landsdowne Road, the cranes are not idle. The stadium is being renovated and will reopen in 2010. "At least someone is drawing a decent wage," says one watching Dubliner.

This year's St Patrick Day's parties were glum, even in Washington, where Brian Cowen, the Irish taoiseach, gave Barack Obama the usual bunch of shamrock (see above). Ireland is having a deeper recession than any other euro area country. The economy probably shrank by 2.5% in 2008 and may contract by another 6.5% this year. Unemployment has jumped from 5% to 10.4%, a faster rise even than in America. Irish banks may be free of the toxic securities that have poisoned rivals' balance sheets, but they are blighted by souring property loans. And a crisis in public finances has forced the government to bring in an emergency budget on April 7th.

To envious observers, Ireland's fall from grace is an overdue payback for its previous swift rise. Between 1990 and 2007 the economy grew by an annual average of 6.5% (see chart 1). It is easy now to dismiss the rise in living standards in the "Celtic Tiger" years as illusory, particularly as Ireland enjoyed house-price and credit booms that were big even by British standards. But to focus on the bursting of the housing bubble would be to miss the lasting gains that were made.

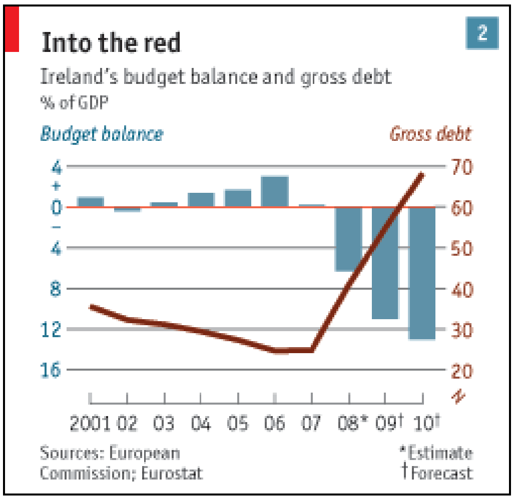


Ireland's expansion went through two phases. The first, led by exports and powered by foreign direct investment, ended roughly in 2002. Foreign companies, mainly American, provided bags of capital and know-how. Ireland offered in return a young, educated, English-speaking, low-cost workforce. State grants, a low corporate-tax rate and access to the EU's single market made things sweeter.

That gave way to a period of growth on weaker foundations. Low interest rates, a consequence of euro membership, lit a fire under property prices and spurred a building and retailing boom. The boom got a fillip in 2004 as migrants from the EU's new members flooded in. Continued growth gave the impression that all was well. But as one Irish economist notes, the Celtic Tiger had already vanished.

When the bubble burst, it left a legacy beyond the pile of unsold houses and bad debts. The housing boom had chipped away one pillar of Ireland's appeal: its low costs. Inflation had picked up and unit labour costs (ie, pay adjusted for productivity) rose sharply relative to Ireland's main trading partners. A recent study by the European Central Bank found that Irish unit labour costs had risen by a third between 1999 and 2007, the biggest jump in the euro area. A healthy current-account surplus in the mid-1990s had turned into a big deficit a decade later, a sign that Ireland had become too pricey.

One contributory factor was a big rise in public-sector wages after a 2002 review. State workers grumbled that they had been left behind by the private sector. The review led to a hefty increase in pay, a symptom also of a generally lax approach to public finances. Charlie McCreevy, finance minister between 1997 and 2004, scorned the notion that fiscal policy should lean against the business cycle. "When I have the money, I spend it. When I don't, I don't," he once said. Cuts in income tax left public finances too dependent on windfall revenues from VAT on new homes, capital-gains tax and stamp duty. Those revenues dried up swiftly once house prices and sales slumped, pushing the budget into deep deficit.



The fragile economy and a continuing loss of competitiveness have made bond markets nervous about Ireland's ability to dig itself out of its fiscal hole. The yield on Ireland's ten-year government bonds, at 6%, is way above those of Germany, at 3.2%. Both countries borrow in euros, so the gap is a rough guide to how creditworthy investors consider Ireland to be.

One big concern is the cost of the state's guarantee of bank debts, hurriedly given last September. The assets covered are worth 2-3 times annual GDP, not the 7-8 times quoted by some, says Patrick Honohan, at Trinity College, Dublin. The banking system looks big on paper but it is swollen by foreign banks with offices in Dublin and loans abroad. These are not key to Ireland's economy, so the government does not have to stand behind them.

Even so some of the guaranteed banks' assets are sure to turn bad. Kevin Daly at Goldman Sachs reckons total losses could be €20 billion ($27 billion), or 10% of GDP—mostly from bad loans to property companies. Even on gloomier assessments, the cost ought to be manageable, as Ireland's public debt was low to start with.

Yet the pressing task remains to rein in the budget deficit. The mini-budget in April will be the fourth fiscal package in a year. In February, in the teeth of union opposition, the government introduced a levy on public-sector pensions that cut take-home pay by an average of 7.5%. The pain will intensify in April. Income-tax rates seem certain to rise, some capital projects may be put on ice and more current spending will be cut. The Irish insist on keeping their 12.5% corporate-tax rate. Still, once the economy bottoms out and new measures take their full effect, the 2010 deficit ought to be less scary to the markets.

Some economists would like an agreement that cuts public and private pay in tandem. As a euro member, Ireland cannot devalue to restore competitiveness. So wages must fall. Karl Whelan at University College, Dublin is sceptical that a co-ordinated pay cut is likely or even necessary. "This is a flexible market economy: with a 10% unemployment rate, wages will fall." Indeed, they already are. A Dublin Chamber of Commerce survey found that nine out of ten firms were reducing or freezing pay; almost a third of respondents were cutting executive salaries by 10% or more.

Ireland's response to austerity goes against the grain. In America and Britain, policy is geared to avoiding deflation, which raises the real cost of debt. But Ireland seeks salvation in lower wages, even though its households are also heavily indebted. Whereas many countries want to lift their economies by fiscal expansion, Ireland is tightening its budget. Few other countries face such big deficits. The Irish hope for a payoff in improved confidence among foreign investors and at home. Consumers are aware of the gap in the budget and know tax rises are coming, says Alan Barrett at ESRI, a research institute. Spending may even pick up if the uncertainty over taxes is ended.

There may be regrets about the excesses of the housing bubble, but not about Ireland's globalised growth model."The key is to turn the model back to export-led growth," says Brian Lenihan, the finance minister. "So we have to attend to competitiveness." For all its ills, Ireland has form when it comes to retrenchment: it cut debt sharply in the late 1980s. If adjustment within the euro means wage cuts, that is a price Ireland seems ready to pay.

Unrest in France

Paris in the spring

Mar 19th 2009 | PARIS
From The Economist print edition

A hardening of street protests worries the government

AP

TWO events tested the French government this week. One was a vote of confidence in parliament over France's decision to rejoin NATO's integrated military command. The other was a day of strikes on March 19th in defence of jobs and pay. No prizes for guessing which form of opposition caused more bother. Despite hostility both on the left and in his own party, President Nicolas Sarkozy's government easily won the parliamentary vote. The day of action made ministers more fretful.

All eight of France's big unions joined the protests. Train drivers, postmen, teachers, university lecturers, town-hall employees, carmakers, oil workers, supermarket cashiers and the rest were expected to match the 1m-2.5m who took to the streets in a protest in January. Among the unions' demands are an end to public-sector job cuts, a boost to the minimum wage and a reversal of tax cuts for the rich.

The government is worried not just by crowd numbers. With Mr Sarkozy's popularity low, public opinion seems to be shifting. For a time voters were turning against strikers, but now they may be swinging behind them. Fully 74% said they supported this week's protests, according to BVA, a pollster, up from 69% in January.

Union resistance, too, seems to be hardening. Last week Serge Foucher, the boss of Sony France, was kidnapped and held overnight by workers angry about the closure of a factory (see article). The boss of a Continental tyre factory was pelted with eggs by employees dismayed by its closure—despite a promise to keep the factory going after workers agreed, unFrench-like, to shift up to a 40-hour week.

French governments, haunted by May 1968, are wary of the street. Troublemakers can disrupt orderly protests. Blockades of factories and university campuses are common. A debate at the Sorbonne on the crisis of capitalism was cancelled because of a strike by students. Lecturers have abandoned the lecture halls. The University of Toulouse-Mirail closed for a day after students staged a sit-in. Laurent Fabius, a former Socialist prime minister, talks darkly of "revolts" in the spring.

The recession explains part of the discontent. It is little consolation for voters to learn that their economy is shrinking less than others: GDP is forecast to fall by 1.9% this year, compared with drops of 2.8% in Britain and 2.5% in Germany. The fear of job losses still weighs heavily. Every day sees more redundancies and factory closures. Even Total, the oil giant that has just reported big profits, has announced job cuts in France. Although most of those taking part in the one-day protests are from the public sector, with few of their jobs at risk, their actions draw extra legitimacy from general anxiety about the recession.

The militant tinge to the protests is new. As the Socialists fail to convince, the hard left is reviving, and with it class warfare. It has a new champion in Olivier Besancenot, a postman—himself on strike—and leader of the New Anti-Capitalist Party. One poll now suggests that he is the most credible alternative to Mr Sarkozy, ahead of any Socialist. Mr Besancenot does not miss a chance to side with strikers. He talks of workers' "exploitation", denounces Mr Sarkozy for pandering to the rich, urges "revolt" and calls on the French to copy the rolling strikes in Guadeloupe.

Hard-left politics and union activity are linked. Mr Besancenot is a member of SUD, a radical union bent on maximum disruption. This month, many firms hold elections to works councils, whose statutory role gives the unions their power. At SNCF, the state railway, SUD grabbed 14.9% of the vote last time, and is set to improve on that. It is the second-biggest union at La Poste, the post office. The better SUD does, the more it drags all unions leftwards.

Faced with discontent, the government is torn. It can try to act tough. Mr Sarkozy insists that nothing new will be put on the table after this week's strike. But the unions are betting they can force his hand. After all, he has given ground before. After January's one-day strike, and talks with unions, he announced new welfare measures, better unemployment protection and tax cuts for the low-paid—to the tune of €2.6 billion ($3.4 billion).

The European Union and Bulgaria

A new colonialism

Mar 19th 2009 | SOFIA
From The Economist print edition

The Bulgarians want European help running their government

BULGARIA'S entry into the European Union was delayed by worries over corruption, organised crime and slow judicial reform. When it and Romania joined in 2007, the European Commission was given a "mechanism for co-operation and verification" that lets it monitor reforms and impose sanctions. It duly withheld €220m ($320m) of EU money from Bulgaria in 2008. The Socialist-led government responded crossly, accusing the commission of double standards and of using its monitoring mechanism as a political tool.

In February advisers to the prime minister, Sergei Stanishev, hatched an extraordinary new plan. Under this the commission and other EU members would get more power to intervene where "weaknesses may be qualified as structural and persistent and…cannot be resolved by the Bulgarian government alone". The plan proposes that European officials and diplomats should be involved in monitoring implementation of laws, managing EU funds and supervising courts, prosecutors and investigators. They would follow cases of political corruption and organised crime that the judicial system has been slow to tackle. The suggestion is that such a "partnership" would be better than the commission's mechanism—although that may reflect the fact that it would be directed from Sofia, not Brussels.

Mr Stanishev presented this secret plan to the commission's president, José Manuel Barroso, in early March. The response was cool. A spokesman says that Mr Barroso rejects the notion of a parallel structure to the current mechanism. EU ambassadors to Sofia, who have just been told of the plan, are also sceptical. One senior diplomat says it would be wrong to wrest the carrot and stick away from the commission, which has both political independence and the trust of EU members—unlike the Bulgarian government. Indeed, some ambassadors detect a wheeze by Bulgaria's Socialists to tell voters that the EU has "newly regained trust" in the government before an election in June. Putting the commission and EU members in charge of reforms might also inhibit future criticism.

Despite this negative response, the government is pushing ahead with its idea. It has set the end of March as a target date. The foreign minister, Ivaylo Kalfin, has even suggested a similar scheme for all EU members.

A mechanism for joint government of a country may be a first for the EU, but it is not for Bulgaria. Soviet advisers arrived in force after 1944 to make sure that the newly communist country did not stray from the course of nationalisation, industrialisation and building socialism. Yet most Bulgarians would welcome a wider role for EU officials. In one poll, over 80% of respondents said they did not trust the government, parliament and courts. Almost 75% trust the EU, especially the commission, according to Eurobarometer. A bigger European presence in the government may play well with Bulgarians, even if it makes less difference than they would like.

Russia's economy

Poor little rich kids

Mar 19th 2009 | MOSCOW
From The Economist print edition

As the economy deteriorates, even oligarchs are suffering

RUSSIANS are hardly falling over themselves to watch Dmitry Medvedev's weekly televised talks. Muscovites, it seems, would prefer a Hollywood movie. For one thing, Mr Medvedev has little positive to say. Oil prices have stabilised above $40 a barrel and Russia's two main stock indices have rallied a little. But the torrent of grim economic news flows on. Industrial output continues to collapse, unemployment keeps rising, wage arrears are growing fast—and some big companies may be on their deathbeds.

No wonder Mr Medvedev now calls the downturn "a sort of endurance test". "We have a lot of problems, so nobody can relax," he conceded in his latest fireside chat. Unemployment, he said, had reached some 6m, or 7.5% of the labour force. One recent poll found one in three Russians was expecting to lose their job in the coming months. Industrial output (which includes oil and minerals) fell by a painful 13.2% in February compared with a year earlier. Manufacturing output shrank even more, by 18.3%.

A potent symbol of the pain is Avtovaz, Russia's largest carmaker and producer of the ubiquitous Lada. It has been taken over by the state-controlled Russian Technologies Corporation. Yet as demand for its cars evaporates, its problems have become so acute that more than half its assets are pledged to repay existing loans. Bereft of access to fresh capital, it is struggling even to buy parts from third parties. Like carmakers in other countries, it wants more government help in cash or tariffs. A jittery Kremlin, nervous of mass unemployment and of social unrest, is likely to agree.

Meanwhile wage arrears, a grim reminder of Russia's chaotic 1990s, are ticking ever higher. Official data show that over half a million people had their pay temporarily withheld in February, the highest number in more than three years. Some analysts say those figures, based on information from employers, tell only part of the real story.

As the pain spreads through the economy, the Kremlin is appealing to an unlikely constituency: the oligarchs. Mr Medvedev devoted part of his latest fireside chat to lecturing them on the need to preserve jobs, saying they must play "a moral role". Arguing that the country's businessmen had got rich improbably quickly, he said they now had to help out. "It's time to repay debts, moral debts," he said. "If a person really has become a businessman, he knows how to value his employees."

The Kremlin cannot afford to bail out the oligarchs much more than it already has, but it clearly expects them to do their bit to hold down job losses. That much has become clear in a recent inter-oligarch spat. Mikhail Fridman's Alfa Bank has been pressing Oleg Deripaska's holding company, Basic Element, to repay a loan of about $650m. Mr Medvedev has now waded into the row. It was, he said, "unacceptable" for even a legitimate creditor to halt the work of such a big company.

He duly summoned Mr Fridman to the Kremlin. Hours later, the two oligarchs issued a conciliatory statement, suggesting that, for now, the heat was off Mr Deripaska. Yet the oligarchs are not what they were. Mr Deripaska, once said to be Russia's richest man, is desperately working out how Rusal, the aluminium company he controls, can repay its mountainous $14 billion of debt. Even Elena Baturina, Russia's richest woman and the wife of Moscow's mayor, Yuri Luzhkov, is suffering. She has applied for $1.4 billion in government loans for Inteko, her construction firm.

As commodity prices have swooned, Russia's rich have seen their wealth diminish. In 2008, says *Forbes* magazine, Russia had 87 dollar billionaires. Now it has 32. As the oligarchs face impatient creditors, there is only one place they can turn to for help: the Kremlin. It publicly opposes more state control of the economy. But if the situation keeps deteriorating, it may end up owning bigger chunks of it whether it wants to or not.

Italy's opposition

New leader, old problems

Mar 19th 2009 | ROME
From The Economist print edition

Dario Franceschini makes his mark

AFP

WHEN Italy’s main opposition group, the Democratic Party (PD), chose Dario Franceschini as its leader, many assumed that he would be a stopgap. The party was in shock. Its first leader, Walter Veltroni, had quit after a disastrous election result in Sardinia. The role of the lean, bespectacled Mr Franceschini was to hold the fort until a cool-headed choice could be made in the autumn.

It was Italy’s prime minister, Silvio Berlusconi, who first hinted that things might turn out differently. He warned his lieutenants not to underestimate the new man. Mr Franceschini, a young-looking 50-year-old, has an incisiveness altogether lacking in his predecessor. Ask him if he is a temporary leader and he instantly shoots back: “All leaders are temporary. Only Berlusconi thinks he’s irreplaceable.”

Reportedly, Mr Berlusconi’s main reason for respecting his new opponent was that he comes across well on television. But in his first four weeks Mr Franceschini has twice wrong-footed his opponent on issues of substance, not image.

He is fortunate to have taken over just as the global recession is hitting Italy. So far Mr Berlusconi has pushed through only limited counter-measures, insisting that Italy is better placed than other countries to weather the storm. That leaves him vulnerable to accusations of complacency. Mr Franceschini proposed that Italy’s unemployed should each get a monthly cheque from the state. Many have only partial entitlement to welfare benefits. Mr Berlusconi dismissed the idea as “unsustainable”. His rival then came up with another wheeze: to add 2% to the income-tax rate of Italy’s richest citizens (those with earnings over €120,000, or $160,000) and use the proceeds to alleviate the plight of the poorest. The prime minister responded: “You don’t solve problems with alms.” He also argued that Italy’s huge public debt (more than its GDP) makes generosity reckless.

“I have the impression”, says Mr Franceschini, “that he thinks that, since the crisis is global, the only responses are global.” The PD’s leader is not alone in pressing for more. On March 18th the head of the employers’ federation, Emma Marcegaglia, was summoned by Mr Berlusconi after complaining that business needs “real money”, not old commitments dressed up as a stimulus. The outcome was a €1.3 billion loan-guarantee fund for small firms.

On the defensive for the first time since returning to office in May 2008, Mr Berlusconi has tried to discredit his opponent as a “Catholic communist”. Even his most purblind supporters knows this is nonsense. Mr Franceschini’s family is a near-perfect expression of the “two Italys” that emerged from the second world war. His father was a partisan, but not a communist; his grandfather on his mother’s side was a fascist. The young Dario threw himself into politics in reaction to the troubles of 1968. As Italy slid into the nightmare of terrorist violence, he became a Christian Democrat. But perhaps because of his

origins in the solidly "red" region of Emilia, he gravitated to the left of the movement. After the demise of the Christian Democrats in the early 1990s, his faction emerged as potential allies for the old communists who had renounced Marxism.

The fusion of these two groups in 2007 created the party that Mr Franceschini now leads. Its inherent bipolarity provides him with his biggest problem. Incessant bickering destroyed Romano Prodi's centre-left government in 2006-08, and also undermined Mr Veltroni. Mr Franceschini may be luckier. Last month's trauma, he says, was salutary. "Now the PD is talking about substance, not about itself."

He is under no illusion about the size of the challenge, or how long he may have to persevere. "My mission and that of my generation of politicians [on the centre-left] is to build the Democratic Party and, at the same time, demonstrate that Berlusconi can be bested. But in 2013. With the majority he has, his government can last another four years. It's going to be a long journey."

Charlemagne

Fingers in the dyke

Mar 19th 2009
From The Economist print edition

The Netherlands typifies a European fear that any big fiscal stimulus might just benefit others

Illustration by Peter Schrank

BARACK OBAMA, no less, has decried as a “phoney debate” the idea that Europe and America disagree on the need for a fiscal stimulus to fix the economic crisis. The American president was reacting to headlines predicting a transatlantic row at the G20 summit in London on April 2nd. But senior European politicians and officials support him. When it comes to the case for stimulus spending, they say, transatlantic differences are small.

For all that, revealing differences remain over the organisation of stimulus packages. And these are not just divergences between Europe and America. Within the European Union, and indeed inside European governments, arguments rage about the right way to beat the crisis through fiscal policy.

There are several reasons for this. European governments, led by Germany, want to see how a first wave of stimulus plans works before committing even more money. One senior politician voices wider concerns when he frets that American plans could trigger “hyperinflation”. Ludicrously, an EU summit on March 19th and 20th was due to spend time arguing about a piffling €5 billion ($6.5 billion) infrastructure fund proposed months earlier by the European Commission. Unedifying reasons for this dispute include demands from southern countries to get more from the communal fund, plus a German request to give Deutsche Telekom a “regulatory incentive” to build a rural broadband network, ie, bend EU rules to allow it a temporary monopoly.

But a purely political headache also explains some of Europe’s resistance to fresh stimulus plans. Many EU governments face the same sources of pain: rising unemployment and a corresponding rise in welfare bills, falling tax receipts, soaring deficits and public debt. If they are lucky and come up with the right stimulus packages, this pain could lead to gain, through a return to sustainable growth. But here is the catch: all the sources of pain are national, yet the potential gains are all international.

Individual EU governments set their own (very different) tax rates and run their own (equally diverse) welfare systems. Unemployment is a national problem. National public accounts will end up groaning under the weight of public debt. But thanks to the EU’s single market, the gains from a return to growth will not remain within one country’s borders, nor will that growth be controlled by any one government. Such paradoxes make many national politicians anxious.

The Dutch prime minister, Jan Peter Balkenende, recently admitted that EU governments were under “intense pressure to use scarce tax revenues mainly for our own countries”. Indeed, the Netherlands

offers a case study of European procrastination when it comes to fiscal stimulus, not to mention some non-phoney differences between Europe and America.

Mr Balkenende's coalition government has spent weeks locked in painful talks over a fresh stimulus to supplement a modest first effort in November that was aimed mainly at the country's huge financial industry. Within the coalition, the centre-left Labour Party has opposed public-spending cuts. Centre-right Christian Democrats are more worried about the long-term solvency of the state, especially after the government extended guarantees to such giant Dutch financial groups as ING. Earlier this month, the impasse led five leading Dutch economists to write a joint appeal to the country's "quarrelling politicians", urging them to split their differences and agree on a stimulus plan now, offset by "irreversible" commitments to austerity later.

Visiting The Hague, one quickly hears that the country is small and crowded, with tough environmental laws. This means that big infrastructure projects, from new motorways to dams or dykes, take forever to agree and build—far longer than in America, say. The Netherlands has an exceptionally open economy, exporting 70% of output, so it is a leading voice against protectionism of the sort that tempts some American congressmen. The Dutch are also famously thrifty. Raise Dutch wages or cut income taxes, and the new spending power will not just suck in imports, but "leak" into savings.

Going Dutch

The Dutch welfare state is generous, so unemployment (forecast to rise from 3.9% to 9% next year) triggers less instant misery than in America. The government argues that "automatic stabilisers", including higher welfare payments and a falling tax take, amount to a stimulus worth tens of billions, even if you cannot see new bridges and schools being built with it. The flip side is a brutal deterioration of public finances: a projected budget surplus of 1% next year has been revised to a 5.5% deficit.

One of the letter-writing economists, Lans Bovenberg of Tilburg University, says that Dutch politicians know what they have to do, for their sake and for Europe. They have to clean up the banks, even if this prompts voter complaints that Dutch money is helping French and German customers. They have to curb wages to boost exports. Thanks to Calvinist discipline, this should be doable. Most painfully, the Dutch can preserve the long-term solvency of the state only by raising the retirement age, to 67 or more. In political circles, other bold measures are aired, eg, an obligation on future governments to reduce deficits.

Could Dutch politicians pull off these austerity measures? Other EU governments would hardly dare to mention them for fear of riots. The question points to one area where domestic pain can lead to national gain: some countries will emerge more competitive than others. If that hope prompts the Dutch to spend for Europe, that will be good for everybody. Of course, yawning gaps in competitiveness pose long-term problems for monetary union. But frankly, this problem can be faced later.

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The jobless toll

A flood of misery

Mar 19th 2009
From The Economist print edition

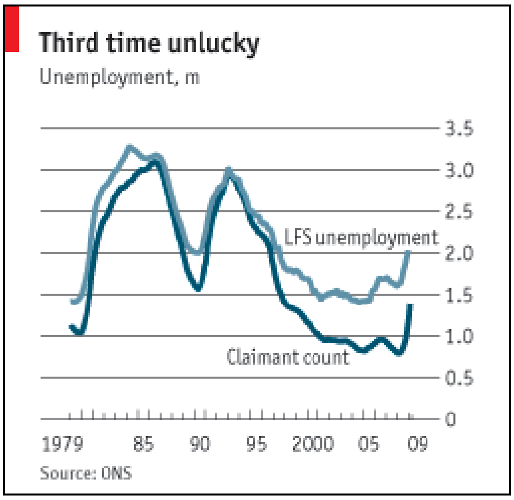
Unemployment surges, and there is worse to come

Getty Images

THIS recession has many victims, but it is in the lengthening lists of ordinary working men and women on the books of job centres and employment agencies that the suffering is most manifest. Their woes are increasing by the hour as mass unemployment returns to Britain, and the consequences are likely to prove far-reaching.

A few years ago it seemed so different. Memories of the two previous job-shedding recessions, in the early 1980s and the early 1990s, were fading. Unemployment rates had fallen to their lowest since the mid-1970s, thanks to prolonged growth and the newly efficient labour market on which Britain prided itself. In its manifesto for the general election in 2005 the Labour Party pledged full employment in every region by 2010. It did not seem implausible.

Almost four years later, the presumptuousness of that commitment has been thoroughly exposed. The latest unemployment figures, released on March 18th, were disastrous. As expected, the wider unemployment count—the number of people out of work and looking for jobs, as the Labour Force Survey counts them—climbed to more than 2m for the first time since mid-1997, just after Labour won power (see chart). On this measure, the jobless accounted for 6.5% of the labour force, also the highest since 1997.



But even these grim findings were overshadowed by something worse: a record rise in the number of people claiming jobseeker's allowance, a narrower measure of unemployment that misses out many women, in particular, because their partners' earnings make them ineligible for the benefit. The increase of 138,400 in February was the biggest monthly jump since comparable records began in 1971. And this is no one-month blip: the average rise of 104,000 in the three months to February was also the biggest on record.

The deterioration in the labour market is not only more marked than in previous recessions, it is also more widespread across regions, sectors and occupations. In the early 1980s it was the industrial heartlands in the midlands and the north that were most stricken as manufacturing firms collapsed. A decade later it was the south of England, especially vulnerable to the housing-market bust, that saw jobless rates rise most steeply. In this recession, by contrast, jobs are vanishing across the country. Early hopes in northern regions that their economies would be sheltered by the relatively large numbers of people working in the public sector have been dashed.

The broad geographical spread of rising unemployment reflects the extent to which a recession generated by the credit crunch has taken casualties throughout the private sector. Home builders brought low by the plunge in housing investment have laid off workers, but so too have manufacturing firms caught up in the collapse of global trade. Financial firms in London are shedding jobs, but so are retailers in high streets up and down the land.

The recession is showing scant respect for social class or occupation. The state's benefit and job-search agency, Jobcentre Plus, which typically deals with mainstream jobs, is handling almost double the usual number of new claims. Employment agencies are seeing well-paid people who have never before lost their jobs, says Tom Hadley of the Recruitment and Employment Confederation (REC). Representing private firms that mainly specialise in the professional and white-collar market, REC reports the fastest fall in job vacancies since its survey started in 1997. Demand for staff is falling across the board, other than in nursing and medical care.

There is more pain to come. Paul Gregg, a labour-market economist at Bristol University, thinks the surge in unemployment in February is the first of three terrible months as employers catch up with the decline in demand by shedding labour. Subsequent increases will be smaller, but even if the economy starts to recover at the end of this year, as the Bank of England predicted in February, he does not expect unemployment to peak until well into 2010.

That peak now looks increasingly likely to match the dismal record of previous recessions and exceed 3m people. The gap between the wider measure of unemployment and the claimant count is likely to narrow in any case as jobseekers who are not entitled to benefit give up and are reclassified as “inactive” rather than unemployed. In earlier downturns, the jobless have been pushed off the claimant count and onto incapacity benefit. But this time reforms to encourage long-term welfare claimants (including single parents) into work will tend to push up the claimant count, points out Mr Gregg.

Those reforms look spectacularly ill-timed (see article). Despite the government's protestations that it will press ahead with them, the immediate priority will be dealing with the newly unemployed. James Purnell, the work and pensions secretary, thinks that it is vital to prevent short-term claimants from turning into long-term jobless. To this end, the state will give businesses that hire people who have been unemployed for six months or more £1,000 per worker, with a further £1,500 for training.

The strategy makes some sense, although much of the money is likely to go to employers intending to hire anyway. But it is a meagre sandbag against the rising waters of unemployment. That flood will engulf the economy, as those who lose their jobs spend less and those who keep them save more in case they too are sacked. And it is not only GDP that will suffer; the return of mass unemployment could prove lethal to any remaining chance that Labour will cling to power at the next election.

Welfare reform

Forward, not back

Mar 19th 2009
From The Economist print edition

As joblessness soars, benefits claimants will be nudged into the labour market

THE dismal labour market has not sapped the government's ardour for welfare reform, nor that of voters. On March 17th the House of Commons approved a bill to make most of those on out-of-work benefits take steps towards getting a job. Campaigners for single parents and the poor say a recession is no time to get stingy. Surprisingly few Labour backbenchers seem to agree.

Ministers point to the scheme's carrots rather than to its myriad sticks. Help to get welfare recipients into work is to become bespoke. Far from aping the American reforms of 1996, which imposed a time limit on access to benefits, James Purnell, the work and pensions secretary, looks to northern Europe, where intensive back-to-work advice allows generous benefits to co-exist with low unemployment. But this is tough love: sanctions will fall on claimants who fail to meet various conditions, and doctors will reassess those on incapacity benefit to identify those able to work.

The reforms enjoy the tailwind of public opinion. A YouGov/Compass poll in February of Labour Party members—who might have been expected to be most hostile to welfare reform—found that half of those surveyed wanted it to go ahead as planned, despite economic circumstances. Only 35% favoured delaying reform until the recession was over. Public attitudes towards welfare had already begun to harden before the recession, according to research led by John Hills, of the London School of Economics. Whereas 48% believed unemployment benefits were too low in 1996, only 23% did in 2006, and those who thought claimants could find a job if they really wanted one rose from 39% to 67%.

That could change, of course, as unemployment bites more deeply, but politicians seem convinced that welfare reform is a vote-winner. The Conservatives, who once outflanked the government on the issue, have been thrown by Mr Purnell's embrace of it. The choice in January of Theresa May to be his opposite number was criticised. Mrs May is a solid but hardly bold performer who is squeamish about prodding lone parents of young children into work. The Tories then gleefully welcomed Sir David Freud, author of the government's welfare reforms, to their front bench last month, but his appointment was a tacit admission of the party's weakness on the issue. A Populus poll this month showed that voters favour Labour on welfare reform.

Its fate remains precarious, however. The burgeoning claimant count means that job advisers may be too thinly spread to offer personalised help, as a Commons committee recently pointed out. Private welfare-to-work firms, who will be paid only if they find jobs for the jobless, have been offered fresh incentives to bid for contracts. But having pursued welfare reform only fitfully when times were good, the government can hardly complain that its latest, more radical efforts have fallen on bad ones.

Nuclear weapons

And now for some light relief

Mar 19th 2009
From The Economist print edition

Gordon Brown holds forth on Iran

SEEKING solace in international affairs from domestic bleakness is becoming as much a Brownite gambit as it was a Blairite one. But when the prime minister goes global he seldom strays beyond his economic comfort zone of trade, aid and financial summitry, which made his speech on Iran on March 17th all the more intriguing.

The twin threats of nuclear proliferation and climate change should be fought, Mr Brown told his international audience of scientists, officials and industrialists, with a range of measures, including a fuel-assurance scheme. Nuclear powers would help other countries develop civil nuclear energy while tightening safeguards against those who would weaponise the technology. Iran would be a "test case" (see article). And to set a moral example, Britain would consider diminishing its own stock of warheads, in co-operation with others.

The speech mainly crystallised existing policies, and David Miliband, the foreign secretary, had set out similar thoughts in February. Britain has made useful contributions to non-proliferation over the years, using its know-how to solve fraught technical and scientific problems. But it is not a big enough nuclear power to cause general disarmament.

Yet the speech mattered because it contained two political omens. First, it raises the prospect that the immemorial split on nuclear weapons between the old Labour right—embodied by Ernest Bevin, the post-war foreign secretary who was so keen to get a bomb "with the bloody Union Jack on top of it"—and the party's peaceniks, whose policy of unilateral disarmament contributed to Labour's unpopularity in the 1980s, may be revived in opposition. The compromise of retaining but shrinking the nuclear arsenal has recently kept peace in the party; Britain has 50% less warheads than it did in 1997. But dire public finances, and a yearning for idealism after more than a decade of centrist accommodation, may push a defeated Labour tribe into once again forswearing the bomb.

The second portent in Mr Brown's speech is graver. By addressing Iran's nuclear ambitions in less banal terms than have become customary for British politicians, he confronted an issue that hangs broodingly over Westminster. A decision on whether to support or even assist a military strike on Iran may greet the Conservatives if they win the next election. They are split on the issue, though less than Labour, which is riven as much as any Western party by the Iraq war and its aftermath.

Of course, the matter may come to a head on Mr Brown's watch. Little is known of his instincts on the non-economic dimensions of foreign affairs, but he is rumoured to be more hawkish on Iran than is generally assumed. His admiration for Israel plays a part, as do the briefings he receives about Iranian complicity in terrorist strikes against British troops in Iraq.

For now, Britain is focused on bloodlessly deterring Iran from developing a bomb. Mr Brown warns of tougher sanctions. For him the world stage is a relief from a fading economy at home, but it is no less a reminder of his powerlessness.

Financial regulation

Bolting the stable door

Mar 19th 2009
From The Economist print edition

As the City crumbles, is it too late to fix its watchdog?

Illustration by David Simonds

"THE TEMPEST", or "A Midsummer Night's Dream"? Scenes from both plays looked down on Lord Turner in the Drapers' Hall as he explained on March 18th how the Financial Services Authority (FSA), the financial watchdog he chairs, will change and get much tougher. He chose to speak in the heart of the once-glorious City rather than in the casino-country of Canary Wharf, London's wholesale financial district. There, the FSA has made itself perhaps too much at home.

His review anticipates a meeting of G20 leaders in London on April 2nd, which has financial regulation high on its agenda. European, indeed global, co-ordination is an important component of any effective new approach. But no matter what anyone else does, the FSA, whose reputation has been battered by the collapse of various banks under its supposedly watchful eye, must clean up its act at home, as it freely admits. This is a start.

The FSA plans, says its chairman, to look beyond single institutions to the systemic risks they may be heaping up in aggregate. It will check that pay does not give bankers an incentive to take on more risk than the bank can safely manage. It will rationalise the wildly different ways in which banks account for complex assets.

The FSA wants to make banks keep more capital to cushion possible losses on the assets they hold to trade, and proposes bigger charges on those that are likely to be harder to sell in a crisis. It will put less trust in the home supervisors of the many foreign banks with branches in Britain: the bankruptcies of Lehman Brothers and two Icelandic banks had financial repercussions in the host country. European Union banks branch freely in other member states, a principle that may need revision.

All this sounds fine, if overdue; but can the FSA really reform itself without a more radical redesign of the system? Apart from Lord Turner, who took over last September, and about 200 new specialists hired to sharpen supervision, the old crew is still there. "Light touch" regulation, which gave bank bosses plenty of room provided they seemed to know what they were doing, is to be replaced with a much heavier hand, but it is attached to the same people.

Lord Turner talks some fine talk. He dismisses past errors as the result of a mistaken worldwide philosophy which held that markets and those competing in them could safely be left to self-correct. Banks will no longer be allowed to rely on deposit insurance and being "too big to fail" as a basis for taking big bets, he says. But he stops short, as do most policymakers, of calling for a split between banks that operate as a casino, playing the markets actively for profit, and those that see their role mainly as a utility, converting deposits into loans, processing transactions and the like.

Hector Sants, the FSA's chief executive, says his outfit has been seared by recent events but is "tougher and better as a result". A more cynical view is that the FSA has survived as long as it has without bloodletting because it is the brainchild of Gordon Brown.

In 1997 Mr Brown, then chancellor of the exchequer, took bank supervision from the Bank of England and gave it to a new creation, the FSA, with a view to integrating the oversight of increasingly diversified financial firms. The central bank retained theoretical responsibility for the stability of the financial sector, but few tools to secure it. Memoranda of understanding were supposed to ensure seamless co-ordination between the FSA, the Treasury and the central bank in a crisis.

Whether it was the policies or the personalities that were wrong, the system didn't work. But Mr Brown, now prime minister, is not a man to admit that he has made a mistake. Nor does Lord Turner believe that tinkering with the structure will improve supervision. One of the FSA's proposals, however, does include strengthening the central bank's systemic-scrutiny role; giving it power to adjust banks' capital charges to mitigate booms and busts.

Designing sturdier financial regulation is high among most countries' priorities these days. But Britain faces a particular dilemma: it may have to choose between continuing to host the world's biggest international financial centre, with the jobs and revenues this has brought, and cracking down on excessive risk-taking. Investment banks are already threatening to take their trades offshore if the FSA goes ahead with proposed new rules on liquidity.

Lord Turner hopes such rules will be applied globally. But that will happen slowly, if at all. The FSA may enjoy its reprieve only until the next election. Among the many proposals drawn up for the opposition Conservatives is a plan to replace it with one conduct-of-business and one prudential supervisor.

Hospital deaths

Making them count

Mar 19th 2009
From The Economist print edition

How data monitoring can kill patients—or save them

TOO few nurses, too poorly trained; receptionists rather than medical staff assessing arrivals at A&E; high rates of infection by the superbug *Clostridium difficile*; at least 400 more patient deaths than expected in just three years. A tale of a single disastrously managed institution, and yet the failings of Stafford Hospital, which were first picked up by the Healthcare Commission in 2007 and made public in a report on March 17th, have triggered apologies right up the political ladder. “On behalf of the government and the NHS I would like to apologise to the patients and families of patients,” said the health secretary, Alan Johnson. The following day the prime minister, Gordon Brown joined in: “We do apologise to all those people who have suffered,” he told Parliament, adding the usual bromide that it “should never be allowed to happen again”.

This local difficulty has gone national mainly because people suspect that those terrible hospital managers were made worse by the pressure to meet government targets. Both the health secretary and the prime minister deny it, but the commission’s report into the scandalous level of care provides support for the view. It found that hospital managers were chasing stringent financial targets in order to achieve “foundation” status, the badge of honour given to the best hospitals, which comes with more freedom to manage one’s affairs. This led them to cut more than 150 posts, including some nursing ones, and left the hospital seriously understaffed. To avoid breaching the national target that almost all patients in A&E should be seen within four hours, those waiting were sometimes moved to a “clinical decision unit” where they were neither monitored nor treated, and doctors were sometimes moved from treating the very ill to looking after those with more minor ailments.

An object lesson, perhaps, in how target-setting and the use of performance indicators can have perverse results. But it is also a shining example of how health-care data can be used to spot problems fast. The Healthcare Commission started its investigation only because in 2007 it began monitoring routine data on hospital admissions, treatments and outcomes. It soon discovered that, after taking account of factors such as the age of patients, the severity of their illnesses and so on, Stafford Hospital had a consistently high death rate for patients admitted as emergencies: at least 127 deaths for every 100 expected. After checking that the findings were not caused by chance or error, the commission asked the hospital to explain. Its inability to do so triggered a full-blown investigation.

According to David Spiegelhalter, a Cambridge University statistician, the commission’s early-warning system grew out of an inquiry into the Bristol Royal Infirmary (which had high death rates after heart surgery on children) and another into Harold Shipman (which tried to determine whether the infamous doctor’s killing spree could have been detected sooner). Calculations by Professor Spiegelhalter and others suggest that had such monitoring been in place, the extra deaths in Bristol would have been noticed earlier, and the fact that suspicious numbers of Shipman’s patients were dying might have been picked up after he had killed just 60 or so, rather than the 200-plus he is now thought to have murdered.

University fees

The only way is up

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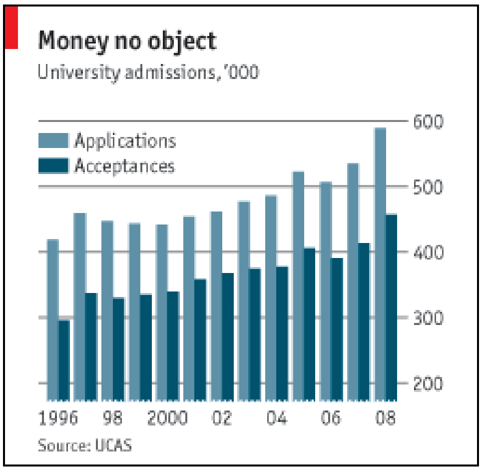
Prospective students should brace themselves

IN 2004, when Labour faced down a coalition of opportunistic Tories and its own backbenchers to force through university fees of up to £3,000 a year, it promised to review the impact in 2009, when the first to pay higher fees had graduated. Would higher prices deter school-leavers, particularly poor ones, from further study?

That review will now not be published until mid-2010: neither Labour nor the Tories are keen to revisit this politically explosive issue before the next election. But it is already clear that higher fees have not put off prospective students. Their numbers have risen inexorably, apart from a blip in 2005-06 when school-leavers passed up a gap year in order to beat the rise in fees (see chart). And although poor 18-year-olds are less likely than richer ones to go on to university, the barriers that hold them back are built years earlier. Research by the Sutton Trust, a charity, shows that students poor enough to be on free school meals who get good A-levels are as likely as their richer classmates to get into university, and to attend elite ones.



The politically motivated hiatus has left the way clear for universities to campaign for a further boost to fees, on the grounds that at current levels these do not fully make up for decades of underfunding. On March 17th Universities UK, a lobby group, published research into the likely impact of various changes. Raising the cap to £5,000 a year would have no discernible impact on demand, the researchers concluded, and most universities would charge that maximum. Only if fees rose to £7,000 a year—nearer to what vice-chancellors said they hoped for—would prospective applicants start thinking twice.

Unsurprisingly, these war-games do not impress students. “In the context of the current recession, it is extremely arrogant for university vice-chancellors to be fantasising about charging their students even higher fees,” says the president of the National Union of Students. In fact, increased demand in previous recessions suggests that universities will have extra pricing power, as school-leavers with little prospect of employment, as well as the newly jobless, become keener on further study.

By allowing universities to decide their own fees, up to a maximum, the government had hoped to see elite universities charging more for their premium product and third-tier institutions providing a value-for-money alternative. But the cap of £3,000-plus-inflation (now £3,145) was set too low for that. Only a handful of universities chose to charge less than the maximum permitted, with most too desperate for the cash and too scared that cheapness, in a business where prestige is vital, would be taken as a sign of poor quality.

So it seems the next government will have to decide not just whether to let universities charge more, but also how high to let them go. (Removing the cap on fees altogether would be unlikely; although both Oxford and Cambridge protest that they have no ambition to match Harvard’s or Princeton’s prices, even the possibility is beyond political contemplation.) But complicating matters is the fact that students can borrow from the government on such easy terms—a zero real interest rate, no repayments until the former student starts earning and debt forgiveness after 25 years—that in the long term repayments will cover only about half the cost of the original loans. Higher fees for students will hit the taxpayer in the wallet too.

Breaking up BAA

Competition at last

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From The Economist print edition

Three airports are up for sale in the midst of a brutal recession

IT WAS one of the biggest, and most heavily leaked, trust-busting decisions in British corporate history. On March 19th the Competition Commission confirmed its provisional decision that BAA, the firm that monopolises Britain's big airports, should be dismembered, selling off two airports near London as well as Edinburgh or Glasgow. Aware that the watchdog was planning such a move, BAA (which thinks the decision "flawed" and is pondering an appeal) had already put Gatwick airport (Britain's second biggest) on the market.

This week's news will come as a relief to passengers familiar with the ordeal of Heathrow, the world's busiest international airport—the delays and crowding that result when an airport designed to handle 45m people a year crams 67m through its doors. Heathrow's runways operate at virtually full capacity, so the smallest hitch causes a cascade of delays. The commission acknowledges that policy-making has been poor and the regulatory regime inadequate. But it lays much of the blame on BAA's near-monopoly on air travel in Britain. Ideally, an expanded Gatwick or, to a lesser extent, Stansted could relieve the pressure. But crowded Heathrow generates plenty of profit and Gatwick and Stansted are also owned by BAA, so reducing congestion is not the firm's top priority. Splitting ownership of the airports should encourage competition between them.

There will be less cheer at Ferrovial, the Spanish construction firm that bought BAA in a swashbuckling £10 billion debt-financed deal in 2006. The forced sale of assets offers the thin consolation of providing cash to pay down some of Ferrovial's £20 billion debt. But Gatwick and Stansted are going on the market at a time when prospective buyers will find it hard to get cash from credit-crunched markets. And aviation is in dire straits. In December Giovanni Bisignani, head of the International Air Transport Association, said his industry was facing "the toughest revenue environment in 50 years". On March 16th the Civil Aviation Authority (CAA), which regulates BAA, said passenger numbers at British airports had fallen by 1.9% in 2008, only the fourth decline since 1945. The fall was steepest in the final quarter of the year, and the CAA reckons that numbers will continue to drop throughout 2009.

All this means that BAA may struggle to get a good price (indeed, on March 13th it extended the bidding deadline for Gatwick by a month, ostensibly to allow more time for due diligence). Heathrow's size and its status as an international hub make it a formidable competitor. Gatwick's regulated assets alone are worth around £1.7 billion, according to the CAA, but many analysts doubt whether the final price will be much more than £1.8 billion (expansion there is forbidden before 2019).

Stansted will be even cheaper, says David Starkie, an aviation expert, who points out that its growth was fuelled for years by a cross-subsidy from Heathrow that was abolished in 2003. The government plans a big expansion, but locals are fiercely opposed and demand may not justify more capacity. Passenger numbers at Stansted fell by 6% last year, whereas numbers at Luton—a rival airport that is not owned by BAA—rose by 2.6%.

The Competition Commission takes a rosier view of future demand, and thinks that breaking up BAA is the best way to encourage new capacity to meet it. Last year ministers approved the building of a third runway at Heathrow (although few believe it will happen). But increasing concern about climate change may alter things. Air travel's share of planet-heating carbon emissions is expected to rise. And the European Union plans to include aviation in its emissions-trading scheme, which should raise ticket prices. More competition will encourage BAA to do better—but it will take a brave businessman to try his hand at it.

Bagehot

The tiny minority

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The uses and dangers of a favourite political euphemism

Illustration by Steve O'Brien

THERE are some sound arguments against the chief medical officer's idea of introducing minimum prices for alcoholic drinks, indexed to their strength, to help reduce the havoc incited by booze. But the main rebuff offered by politicians isn't one of them: that the scheme, as many of them intone, would punish all tipplers for the sins of an irresponsible "small minority".

Most political euphemisms—extraordinary rendition, collateral damage, "misspeaking" and so on—are designed, as George Orwell put it, to make "murder respectable", or at least to camouflage dishonesty or scandal. The small or (more often) "tiny minority" is generally a figment of cowardice rather than concealment: deployed to minimise failure and justify inaction, rather than to finesse evil. It is an increasingly common, and insidious, trope of political rhetoric. Just as "pacification" once meant its opposite, so the "tiny minority" is coming to connote a big worry.

Consider some facts about the bottle. Deaths related to alcohol in Britain are rising fast. Each year there are 800,000 hospital admissions, thousands of road injuries and hundreds of thousands of violent crimes that are partly attributable to drink. Either the small minority of problem bingers is stunningly industrious, or this is more a national malaise than a niche vice.

The same platitude is applied to the related embarrassment of hooliganism by English football fans (less visible recently, because of the national team's failings, but not extinct). The hooligans who shame the country are always, according to the politicians, an unrepresentative "tiny minority". Yet the thugs who battle rivals on French beaches, smash up Belgian town squares or riot in the Algarve often turn out not to belong to a dedicated "hard core", but to be ordinary young men who join in for fun.

Or think of the assorted—and routinely downplayed—nationalisms and extremisms that Britain is host to. Psephologists are unconvinced about predictions of an imminent electoral breakthrough by the British National Party, another outlet for jingoism and worse. But circumstances are propitious, and the prospect more urgent than many politicians allow. Then there are the diehard republican terrorists in Northern Ireland, assumed to have been responsible for the recent killings of two soldiers and a policeman: a psychotic, criminal "tiny minority", says almost everyone. The committed murderers are indeed few. But there are many more who reject Northern Ireland's peace agreement: Catholics who feel betrayed by their leaders, Protestants angry at the accommodations made by unionists. Peace is much more fragile and prickly than pieties about the "tiny minority" imply.

In Britain as a whole the republican threat has now been largely superseded by the danger of al Qaeda-inspired terrorism. This too is always said to involve a “tiny minority” of British Muslims. It was also, Gordon Brown said, a “tiny minority” who yelled abuse at parading soldiers in Luton recently. True, on both counts. But although the number of Muslims who publicly push obnoxious views is small, and the number readying for violence even smaller, surveys suggest that a much bigger constituency holds opinions at odds with basic tenets of liberal democracy (for example, about the desirability of an Islamic state, or the legitimacy of violent *jihad*). The pool of people vulnerable to radicalisation dwarfs, yet is obscured by, the reviled “tiny minority”.

Of deception and delusion

These are very different contexts, but the aim of the euphemism is the same: to minimise, trivialise, make the nastiness go away. The motives are consistent too. Only some are respectable.

Confronted by a challenge that is too big or complicated to meet, politicians also face an unpalatable choice: to pretend omnipotence, which leads to wasteful policies and disappointment; or to pretend the problem scarcely exists. Sometimes there are forgivable reasons for choosing understatement—such as fear of aggravating the trouble. Terrorists can be gratified, extremists inadvertently nurtured and moderates inflamed by inopportune frankness and the publicity it generates.

But sometimes there are self-interested reasons for politicians to enlist the “tiny minority”. One is to dispel the suggestion that they have caused the difficulty in question themselves, or at least exacerbated it. Muslim anger and alienation have been fuelled by British foreign policy: better, from the government’s perspective, to concentrate on the lunatic fringe than to wrestle with the wider disenchantment its policy has contributed to.

And sometimes the calculation behind the euphemism involves bald electoral costs rather than the cost to the country. That is true of many politicians’ attitude to alcohol and the chief medical officer’s proposal. There are simply too many drinkers (ie, voters) for ministers to risk antagonising, especially during a slump which has made other pleasures less affordable and the government even less popular than it was already. So the message to most of them is: go back to the pub, keep your Chianti and give us your votes. The “small minority” is the problem, not you.

There is a final political factor at work, one founded in a basic psychological need. To be elected, politicians need to offer hope and congratulation as well as criticism—to sell a vision of a good society—because most people like to think well of themselves and their future. Few enjoy the thought that their country gestates drunks and hooligans or is imperilled by fanatics. Insisting that worrisome minorities are “tiny” is in part a form of wishful thinking, as if saying something often enough could make it true, and rhetorical tininess could shrink reality.

This sort of euphemism is sometimes a kind of self-delusion as well as a deception. But it is perilous all the same. All those tiny minorities add up to a society in denial.

Bagehot now writes a blog, which is open to comment at
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Nuclear power

The critical issue of safety

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The much-heralded renaissance of nuclear power will fail unless the public can be convinced that all plants, worldwide, are safe

picturedesk.com

FILMS do not often cause diplomatic incidents. But in November last year the Czech Republic's ambassador to Austria protested against "The First Day", a fictional account of the aftermath of a nuclear accident at Dukovany, a real-life Czech plant near Austria's border. Austria voted in 1978 to ban nuclear power, and its public-service broadcaster showed the film to celebrate the 30th anniversary of the referendum. Not only is the Czech plant portrayed as a menace to Austrians, but the Czech authorities withhold vital information from their neighbours after the accident.

Austria's long-standing fear of the atomic plants over the border demonstrates why nuclear safety is an international matter. After the accident at Chernobyl in 1986, which was caused by operator mistakes and which spread radiation beyond Ukraine across swathes of Europe, the International Atomic Energy Agency (IAEA) called for more global co-operation on safety. It introduced a Convention on Nuclear Safety and an improved set of safety standards. The nuclear-energy industry, fearing for its survival, also formed the World Association of Nuclear Operators (WANO), a system of "peer review" under which utility companies that belong inspect each other's nuclear plants and exchange safety information. Both the IAEA and WANO standards are voluntary.

Whether through luck or because of improving standards, the nuclear industry has had a better safety record since Chernobyl. The design and monitoring of many reactors has improved. There have been plenty of leaks and other safety incidents, including several in Japan and a serious near-miss at an American plant in 2002, but no known big accidents resulting in deaths. Meanwhile, governments worried about climate change and energy security have noted that nuclear plants emit no carbon dioxide and the raw material for their fuel, uranium ore, can be supplied by friendly, reputable places like Australia.

That, and the recent spike in oil and gas prices, has prompted many governments to look again at nuclear power. In February Italy and Sweden announced plans to start building plants again. Italians had voted to ditch nuclear power a year after Chernobyl; Swedes did the same in 1980, a year after the smaller accident at Three Mile Island in Pennsylvania. American power companies may start building reactors again by the end of this year. Most of the 40 or so plants now under construction are in Asia (many in China) or Russia, but countries in Latin America, the Middle East and Africa are also either building or planning reactors. Among those contemplating building their first ones are Turkey, the United Arab Emirates, Indonesia and Belarus.

Yet public fears about the safety of nuclear power could still derail its revival, at least in richer, democratic nations. In many countries, majorities oppose building new reactors. People fear nuclear accidents, terrorist attacks, the long-term risks of storing radioactive waste and of nuclear fuel being diverted to build weapons (see article). So far, no country has succeeded in building a permanent geological repository for high-level nuclear waste, and only Finland has secured public acceptance for a site.

Concern about climate change has softened opposition a little. According to a poll by the European Commission last year, 44% of people in the European Union now broadly support nuclear energy, up from 37% in 2005; and 45% oppose it, down from 55%. However, in 2007, when the pollsters posed a more detailed question that explained the environmental benefits and safety risks of nuclear power, 61% said its share of the energy market should be cut. In America, too, says Eugene Rosa of Washington State University, everything depends on the question. About 80% of Americans say they think nuclear power will be "an important future source of energy". But when a Gallup survey in 2007 asked whether people were in favour of expanding the use of nuclear energy, 50% were in favour and 46% were still against.

The extent to which public opposition can block or reverse the building of new nuclear plants will vary between countries. Luis Echávarri, director-general of the OECD's National Energy Agency (NEA), says such plants must survive changes of government and thus require "a solid political and social base". The simplest course would be to build new reactors at existing nuclear sites—in America, 14 of the 21 applications to start building are for existing sites, where permission is easier.

Areva

Olkiluoto: being built with consent

Developing-country governments are less likely to care whether the public backs the expansion of nuclear power. China has 11 nuclear-power reactors already and plans another 20. Companies from the rich world—such as France's Areva and America's GE—will find it far easier to build nuclear power plants in the developing world than at home.

Another big accident anywhere could still halt nuclear-energy programmes around the world. The industry's safety record since Chernobyl means there is a danger of complacency, says Philippe Jamet of the IAEA. So steps must be taken to ensure that less-developed countries run their reactors safely. Last year France created an agency to help newcomers design nuclear laws and set up independent regulators. Some wonder if China's rapid expansion in nuclear power is being achieved with proper levels of safety. Its regulator may have all the right intentions but it is said to lack resources and enforcement capability. There is also a looming shortage of qualified nuclear engineers, after the three-decade hiatus in building new plants.

Should the IAEA's safety rules stay voluntary? The agency's experts are invited in to look at nuclear reactors around the world and, as a United Nations body with the Security Council's ear, its visits are more feared than those of WANO. But governments decide which plants to show, and when. In November last year the European Commission proposed making the IAEA's safety rules legally binding throughout the European Union. It hopes other regional blocks, such as those of South-East Asia and South America, will follow suit.

Making IAEA standards compulsory everywhere may be hard to achieve. "But it will become increasingly difficult for a country not to invite a peer safety review," says the agency's Mr Jamet. WANO is considering making peer review compulsory for each new plant opened by one of its members. An important question is how increased competition among nuclear-energy firms will affect co-operation on safety, says Pierre Gadonneix, the boss of EDF of France, the world's largest operator of nuclear plants. Nevertheless, he says, "We are sure that transparency and sharing of information on safety will survive in a newly competitive environment."

A new reactor being built at Olkiluoto in Finland is one of only two under construction in western Europe. It has become a byword for spiralling costs and delays. But the Finnish experience is exemplary in other ways, argues William Nuttall of Cambridge University: the government gave the local community a large say in choosing the site of a radioactive-waste depository at Olkiluoto. Switzerland and Canada have taken a similarly democratic approach to nuclear power.

This is a welcome contrast to the secrecy that characterised much of the nuclear industry's interaction with the public in the past. In some countries that secrecy stemmed from the military uses of nuclear fission. But the legacy of Chernobyl and other accidents has changed that. If the industry is to thrive, safety needs to be paramount, wherever new reactors are built.

Economist.com WORLD INTERNATIONAL

Proliferation and nuclear power

Fuel for thought

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Schemes to take the military danger out of civilian nuclear power

NUCLEAR power for all who want it, without helping those who would abuse it? A similar dream in the 1950s later turned to nightmare, as India, Israel, Pakistan and South Africa—and others until they were stopped—bent the materials and technologies offered as “atoms for peace” to bomb-making.

Many suspect Iran is misusing technology for enriching uranium and producing plutonium (ingredients in both reactor fuel and nuclear weapons). Anxious to head off imitators, some governments and the International Atomic Energy Agency (IAEA), the UN’s nuclear guardian, have plans to guarantee fuel supplies: countries building civilian nuclear reactors would then have no need or excuse to dabble in such proliferation-prone technologies.

At a London gathering of governments and industrialists from fuel-making and fuel-using countries this week, Britain’s prime minister, Gordon Brown, said Iran will be a test case. No other country has built a uranium-enrichment plant without having a working reactor to use the stuff; the Iranian one nearing completion at Bushehr will run on Russian fuel. America, Russia, China, Britain, France and Germany have offered Iran help with nuclear technology, including reactor design and fuel supplies, if it comes clean about its nuclear past and stops enriching long enough (that could take a while) to convince inspectors that its work has no military purpose.

A dozen schemes have been proposed to reassure others planning civilian reactors that they can reliably buy fuel from existing suppliers. Earlier this month Kuwait became the 31st (and clinching, cash-wise) government to support a project launched by the Washington-based Nuclear Threat Initiative to help the IAEA set up and control an international fuel bank of last resort. Any country meeting agreed criteria, yet finding its fuel supply cut off for political reasons (not commercial bickering or proliferation concerns), could get speedy IAEA help. An outline proposal will go to the agency’s 35-country board in June.

Russia has opened an enrichment plant at Angarsk to outside investors, who can share in profits and product but not technology. It has also offered to set aside 120 tonnes of low-enriched uranium (it takes a higher-enriched sort for a bomb) that the IAEA could call on if needed. America is already blending down some of its highly enriched uranium to make it available for civilian use. Britain is proposing a fuel-assurance scheme involving Urenco, a Dutch-British-German enrichment consortium.

Germany has also proposed setting up a multilateral enrichment centre, to be built, preferably, in a country that does not already enrich uranium. It would broaden the assurance of supply. But it would require far tougher anti-proliferation safeguards than apply to the nuclear industry today.

Agriculture

Green shoots

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No matter how bad things get, people still need to eat

eyevine

AT A time when much of the global economy is falling apart and demand both for consumer goods and the firms that make and finance them is collapsing, the notoriously cyclical world of agriculture is holding up remarkably well. Prices for grains and meat are down from the peaks of mid-2008, but are 30-50% above their averages over the past decade. There is reason to believe that this strength is more than just another of the many bubbles that have recently inflated, only to pop.

Higher prices are hardly a universal blessing: they are good for farmers, many of whom are poor, but bad for consumers. Some of the increase can be blamed on the shift of crops from food to fuel, prompted by wildly inefficient subsidies. But high prices are also a sign of progress because their single largest cause is the steady increase in demand from poorer countries, as people there eat more food—especially more protein. More people are better nourished thanks to a bit more grain, a lot more meat, and much more milk.

China's role has been profound, reflecting its enormous economic progress and huge population. In the past decade, says Carlo Caiani of Caiani & Company, an investment-advisory firm based in Melbourne, the consumption of milk has grown seven-fold, and that of olive oil six-fold. China is consuming twice as much vegetable oil (instead of less healthy pork fat), 60% more poultry, 30% more beef and 25% more wheat, and these are merely the obvious foods. Scores of niches have expanded dramatically: people are drinking four times as much wine, for example.

And yet even with all this growth, people in China still, on average, consume only one-third as much milk and meat as people in wealthy countries such as Australia, America and Britain. The gap is even larger with India, which is also growing fast. Overall, protein intake in Europe and America is unlikely to expand much, but a combination of rising incomes and population in developing countries could increase demand by more than 5% annually for years to come. "Once people are accustomed to eating more protein, they won't take it out of their diet," says Mr Caiani.

Expanding supply at the same rate will be difficult, because the amount of arable land under cultivation is growing by only a fraction of a percentage point each year. In China and India many of the most fertile areas are the ones being developed for roads and factories. That means existing land is becoming more valuable, and must become more productive.

The consequences stretch from one end of the food chain to the other, as higher food prices prompt a response. BASF, one of the world's largest producers of agrochemicals, saw 9% growth last year in agricultural sales, including 16% growth in Asia. It expects the industry to grow by 17% this year, which has begun well, the global economic tumult notwithstanding.

Its competitors are also prospering. The share prices of Agrium, CF Industries, Bunge and Syngenta spiked last year along with food prices, then tumbled (along with the shares of nearly every other company), but then stabilised, even as the rest of the stockmarket continued to tank. Monsanto, which a decade ago had been praised and then trashed for selling highly efficient genetically modified seeds, has seen its popularity restored for exactly the same reason. After years of strong growth, and with the prospect of more to come, its shares are valued at 20 times trailing earnings, nearly double the market average.

Interest in the industry is still growing. A conference for fund managers tied to agriculture held annually in Sydney by Austock, an Australian broker, attracted a few dozen contrarian souls three years ago. This year's event, which began on March 16th, had to be restricted to several hundred ticket-holders, with many others turned away. Deals are also being done. On March 13th Terra Firma, a private-equity firm based in London, announced it would buy 90% of Consolidated Pastoral Company, the vast Australian cattle holdings of the Packer family, which encompass 5m hectares (12m acres) of land.

In February Nufarm, an Australian agrochemical maker, won approval for its acquisition of AH Marks, one of Britain's oldest chemical companies, which has a valuable portfolio of herbicides. Nufarm itself only barely avoided being acquired in 2007 in a joint bid by an American private-equity firm and a Chinese state-owned company. Shares of Mosaic, a maker of fertiliser, have been swept by one acquisition rumour after another. Last year COFCO, China's state-controlled food conglomerate, bought 5% of Smithfield, the world's largest pork producer. Al Qudra, an Abu Dhabi-based investment company, said it had bought big tracts of farmland in Morocco and Algeria, and was closing in on purchases in Pakistan, Syria, Vietnam, Thailand, Sudan and India.

In November China Agri-Industries, a subsidiary of COFCO, established a partnership with Wilmar, the world's largest trader in palm oil. Landkom, listed on London's AIM market, and Black Earth Farming, listed in Stockholm, have each made big investments in farming in Ukraine. And reports are circulating in China about local investors buying 50,000 hectares of farmland in Argentina, and considering other investments in Argentina and Brazil.

Even China is finally opening up to private agricultural investment, in part because new laws allow farmers to lease land, thus making possible economies of scale. Asian Bamboo, a company that is listed in Frankfurt, leases 27,000 hectares in Fujian province. It announced profits for 2008 of €21m ($30.4m) on sales of €44m, reflecting how, at least for the moment, agriculture can be an extraordinarily high-margin business.

There are limits to what can be done, however. By far the most ambitious of all the land deals in the past year was Daewoo Logistics' contract with the government of Madagascar to lease 1.3m hectares, almost half the country's arable land, to produce corn for Daewoo's home country, South Korea. But after riots and a coup in Madagascar, the deal is off. These tensions are not unique. In response to local concerns about the loss of critical food supplies, several governments have imposed taxes or other restrictions on exports: on a key ingredient of fertiliser in China, on grain in Argentina, on rice in India. That sort of meddling undermines some investments and businesses. But in a strong market, it makes the businesses that can operate freely all the more lucrative and valuable.

Industrial relations

Kidnapped

Mar 19th 2009 | PARIS
From The Economist print edition

Bosses are taken hostage in France

SERGE FOUCHER, the head of Sony in France, was taken hostage on March 12th by factory workers seeking better severance terms. They shut him in a meeting room and barricaded the plant with huge tree trunks. Released the next day, Mr Foucher seemed to take things in his stride. “I am happy to be free and to see the light of day again,” he said.

Business people in France are not amused. They note that the authorities did not ask the police to free Mr Foucher. Instead, the local deputy prefect accompanied him into further talks with the workers, who got what they wanted: a better redundancy deal. It all confirms France’s general lack of sympathy for business, complains one executive.

Taking executives hostage is a well-established tactic in France, which has a history of confrontational labour relations. But it seems to be becoming more common. In January 2008 the British boss of an ice-cream factory was held hostage overnight after announcing plans to fire over half of its workers (on that occasion, the police did intervene). In February 2008 the head of a car-parts factory was seized after workers realised that he was planning to move the operation to Slovakia. Ten days later, workers at a tyre factory owned by Michelin locked in two senior executives in protest at plans to shut the plant.

Workers in other countries take bosses captive on occasion, but France is the only nation where it happens often. Might the practice spread? “Because of the state of the world economy, it would not surprise me if bosses were held hostage by workers more frequently,” says David Partner, a kidnap and ransom expert at Miller Insurance, an insurance broker affiliated with Lloyd’s of London.

Sit-ins are already becoming more common. In December workers occupied a window factory in Chicago for five days to secure severance pay that they were owed. In February workers from Waterford Wedgwood in Ireland marched on the offices of Deloitte, an accountancy firm, and refused to leave until they got a meeting with the company’s receiver. In America, says Gary Chaison, professor of industrial relations at Clark University in Massachusetts, workers are likely to become more militant, because of a sense of injustice over pay. “I could easily see executive hostage-taking happening here within a few months,” he says.

Coca-Cola and China

Hard to swallow

Mar 19th 2009 | HONG KONG
From The Economist print edition

China indicates the real targets of its anti-monopoly law: outsiders

LAST August, after 14 years of debate, the Chinese government at last imposed what was informally referred to as its "economic constitution", a broad anti-monopoly law for a country rife with state-imposed monopolies. Since then people have wondered how the law would be applied, and whether it would advance China's transformation into a market economy, or serve as an impediment to genuine competition. On March 18th an answer emerged with the rejection of the largest outright acquisition by a foreign firm, a $2.4 billion offer by Coca-Cola for China Huiyuan, China's largest juice company.

When the deal was announced last September, it was at a price three times Huiyuan's valuation. Since then, as global markets have collapsed, it has only become more appealing. Huiyuan is a private company and juice had previously been free of government control, so theoretically it should have been available for purchase. "It is a very unfortunate outcome in an industry that has no economic or national-security significance," says Lester Ross of WilmerHale, a law firm, in Beijing.

The most benign interpretation of the rejection being bandied about by lawyers and bankers is that it reflects a political response to critical comments by America's new administration. The more worrying interpretation is that, even as China publicly urges other countries to commit to opening their markets to Chinese investment and trade, it is imposing yet another barrier to outsiders. Worse still, the barriers are in its domestic consumer sector, one of the few global economic bright spots.

Adding irony to the decision, it comes just as the Chinese government is actively encouraging consolidation and greater market concentration in several areas, including steel, cars and airlines, and just after it imposed a new oligopoly in telecoms. No domestic Chinese transactions have fallen foul of the new monopoly law.

Signs that foreign companies might be the primary targets of the law began to emerge in November, when a merger between two brewers, America's Anheuser-Busch and Belgium's InBev, was endorsed by Chinese regulators only on the condition that the combined firm's existing interest in several domestic breweries be frozen. In particular, Anheuser-Busch's non-controlling 27% stake in Tsingtao, a leading Chinese brewer, was largely liquidated in January after what is presumed to be pressure from the government.

The Coca-Cola Company holds around half of the domestic Chinese market for carbonated beverages, but the juice business is highly fragmented. Together, the two firms would control slightly more than 20% of the juice business. In a brief statement, China's ministry of commerce said Coke's "dominant status" might imperil small competitors and force consumers to face higher prices and less choice.

After the decision was announced, investment banks were left wondering, in the words of one employee, whether "a key plank in their business had just blown up." Coke has spent years developing its presence in China, and has invested heavily, presumably making it one of the world's more acceptable buyers. It is also one of the few companies able to finance a big deal in today's difficult circumstances. If Coke was not acceptable to the Chinese authorities, then who would be? The rejection will inevitably be used as evidence of non-reciprocity, and of the collusion between the country's state and private sectors, by anyone opposed to China's recent efforts to buy companies abroad.

Furthermore, another new law comes into effect on May 1st, subjecting any transfer of a state-controlled asset to yet another layer of review, this time by a local commission. Theoretically this is not aimed at any particular kind of acquirer, and would not block well-conceived deals, but that, of course, was said about the monopoly law as well. The new law had not received much attention. It will now.

Information technology

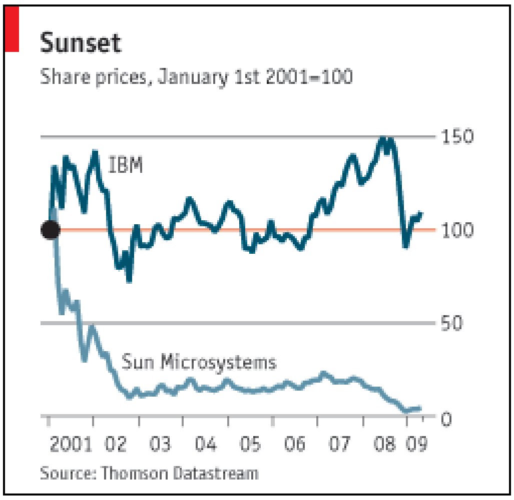
Gathering clouds

Mar 19th 2009
From The Economist print edition

The takeover talks between IBM and Sun highlight a shift in the industry

IT WAS the day Sun Microsystems was supposed to rise again. On March 18th the Silicon Valley computer-maker had planned to unveil a new online service to allow start-ups to manage with much less hardware, by buying computing capacity from a “cloud”, rather like electricity from the grid. But the event was overshadowed by the news, hours earlier, that IBM was in talks to buy Sun for at least $6.5 billion in cash, which would translate into a near-100% premium over the firm’s depressed share price in recent weeks.

As *The Economist* went to press, a deal had yet to be confirmed. But it is no surprise that the two firms are talking. The economic crisis has pummelled Sun, which never really recovered from the dotcom bust. As its share price plumbed new lows, IBM’s remained relatively unscathed (see chart)—a reflection of its business, which has been protected by the computer giant’s global scope and the fact that it makes most of its money from software and services.



In the months to come, more big fish will seek to swallow smaller fry. That is because something deeper is going on in the computer industry. Thanks to ever more powerful chips and new software, servers and other hardware can now be “virtualised”, meaning physically separate systems can act as one. This enables computing power to become a utility: it is generated somewhere on the network (“in the cloud”) and supplied as a service. To simplify their complex data centres and cut costs, more and more companies are thinking about building in-house computing utilities, called “private clouds”, or outsourcing computing to “public clouds” of the kind Sun launched this week.

What is more, as computing becomes a utility, the borders between different systems are starting to blur. A server, for instance, can easily function as a router (a box that directs data around networks). And this convergence means that companies that used to be allies, or in totally different markets, are now starting to compete with each other, argues James Staten, an analyst at Forrester Research.

As a result the industry’s landscape is shifting. Last year Hewlett-Packard (HP), the world’s biggest computer-maker, bought Electronic Data Systems, a big provider of computer services, giving HP more manpower to help its customers build more advanced data centres. HP has also acquired software to manage data centres and put a greater emphasis on networking gear, an important component in the computer centres that have become the heart of many businesses.

Cisco, the world’s biggest maker of routers, has responded by moving into a new area: it will soon start selling servers. Together with other firms, including BMC and VMware, it has developed what it calls a “Unified Computing System”, which was unveiled on March 16th. This is essentially a private cloud in a box. Instead of having to wire up servers, storage devices and networking gear, companies can build and reconfigure virtual computer systems with a few mouse clicks.

For IBM, the third big contender in this emerging field, part of the attraction of Sun is that it has some assets, such as networking gear and data-centre software, which would beef up IBM’s ability to build private clouds. Industry observers think IBM would probably sell many of Sun’s other businesses, however, such as its line of high-end servers. A counter-bid for Sun from HP or Cisco is also possible.

HP, Cisco and IBM (and perhaps Dell, another troubled computer-maker) are gearing up to fight what has come to be called the “war for the data centre”. Much is at stake: this year alone, companies will spend about $100 billion on data centres, according to IDC, a market-research firm. As computing moves online,

however, these companies will increasingly have to compete with operators of “public clouds”. Microsoft plans to enter this field, in effect offering to run companies’ computer systems for them inside its own giant data centres. Google is gradually expanding its suite of cloud-based offerings. And Amazon, the world’s biggest online retailer, is also a pioneer in the field of cloud-computing services, which it has been offering for some time.

In a way, all this is a throwback to the era of “time-sharing” on mainframe computers. In the early days of computing, companies either had to buy a mainframe, which cost millions, or share one with someone else. Now firms will once again be confronted with this choice. Contrary to what some argue, however, big companies are unlikely to go fully either way. In fact, the computing sky will probably always be cloudy, meaning that there will be many private and public clouds, and they will come in all shapes and sizes. And most of them will be interconnected. Cisco already has a name for this computing climate: the “Inter-Cloud”.

The internet

Going AOL

Mar 19th 2009 | SAN FRANCISCO
From The Economist print edition

Google loses an advertising guru

DURING the 1990s AOL helped millions of people get online for the first time, with its dial-up service and friendly e-mail system. This caught the attention of Time Warner, a media giant which merged with AOL in 2001, at which point AOL began a rapid decline. Simultaneously Google began an equally rapid ascent, and it now dominates web search and online advertising. As if to provide a coda to this tale, Time Warner has just poached the man within Google who has the most clout in the advertising industry, Tim Armstrong, and made him boss of AOL.

Tall and diplomatic, dressed more Madison Avenue than Silicon Valley, Mr Armstrong has been trying to extend Google's advertising power from its search-results pages to its other web properties, from video to social networks. Hence his attraction for AOL, which has pegged its future entirely to advertising, and which does not usually get first pick among technology talent. After several rounds of lay-offs, many at AOL are fed up with the old boss, Randy Falco, a former television man, and his deputy, Ron Grant. Both men, collectively dubbed "Rondy", are abruptly leaving.

Some see Mr Armstrong's arrival as a signal that Time Warner plans to spin off AOL. In his first e-mail to AOL's employees, Mr Armstrong wrote that he "would love to hear your thoughts and suggestions on how to make AOL and its sister properties the most powerful brands on the internet." Given AOL's past, there is a certain dark humour to this, particularly coming from a veteran of Google.

Defence companies

In the line of fire

Mar 19th 2009
From The Economist print edition

Why America's defence industry is in for some lean years

EXPERIENCE suggests that shares in defence companies can offer a safe haven for investors during periods of economic turbulence. During the previous two recessions, American defence shares outperformed the market. That is not surprising: more than any other industry, defence is a client of government. And governments set military budgets according to their involvement in wars and their perception of external threats—neither of which has much connection with the business cycle.

But in this downturn, something different is going on. So far this year the S&P 500 index has fallen by 14%, but defence shares have fallen by 22%. The cloud hanging over the industry is the gloomy conviction that after eight years of George Bush, during which the Pentagon's budget more than doubled to $666 billion, Barack Obama is determined to change things.

The reduction in spending is not exactly imminent. The budget for 2010, which will be announced next month, was largely set by the outgoing administration and will be close to 2009's $654 billion. Because of the winding down of operations in Iraq, the Office of Management and Budget currently expects a 4% increase in base funding over 2009—not exactly short rations. It is what will happen in the subsequent years that is worrying the industry.

He has not gone into specifics, but in the past few weeks Mr Obama has given glimpses of his thinking. At a White House fiscal-responsibility summit on February 23rd, he singled out the project to produce a new presidential helicopter as "an example of the procurement process gone amok", and assured his former rival, John McCain, that curbing procurement excesses was one his most urgent priorities. The next day, in a speech to Congress, Mr Obama promised to "reform our defence budget so that we're not paying for Cold War-era weapons systems we don't use."

On March 4th he went further. Citing a recent report from the Government Accountability Office (GAO), which found that 95 big weapons contracts were over budget by a total of $295 billion, he contrasted projects "designed to keep the American people safe" with those "designed to make a defence contractor rich."

Adding congressional firepower to the president's statement of intent is a bill introduced in February by Carl Levin, the chairman of the Senate Armed Services Committee, and Mr McCain, the committee's senior Republican. Its aim is to force the Pentagon to get tough with military contractors that fail to deliver the goods.

It seems clear that Mr Obama is willing to scale back or scrap projects that are of decreasing relevance to America's 21st-century security requirements, or have become embarrassing money pits. The VH-71 programme to replace the helicopters used to carry presidents around certainly falls into the embarrassing category. Lockheed Martin and its partner Augusta Westland, a subsidiary of Italy's Finmeccanica, are on course to supply 28 helicopters at a cost to taxpayers of $13.2 billion.

But more important are the really big-ticket items that are likely to face much tougher scrutiny under the new regime. The air force would like a second batch of F-22 fighters to add to the 187 it will already have by 2011. But after spending more than $62 billion so far on the Lockheed Martin/Boeing plane, spectacularly capable though it is, Mr Obama and Congress may decide that enough is enough. The F-35 Joint Strike Fighter is another programme that looks vulnerable. The GAO said this month that the total investment to acquire 2,456 planes and support them in service will exceed $1 trillion.

The GAO and the Pentagon are also at odds over the army's $159 billion Future Combat Systems (FCS) project, led by Boeing and SAIC, a systems integrator. The GAO reckons FCS is running about $21 billion over budget, and said last week that the programme had "spent about 60% of its development funds, even though the most expensive activities remain to be done before the production decision". Nobody

would be surprised if Mr Obama opted for a cheaper, later and less ambitious version of FCS. The same applies to missile defence, only more so—Mr Obama is a declared sceptic about the whole idea.

Defence firms still have some attractions for investors. As Noah Poponak of Goldman Sachs points out, most have strong balance-sheets and cashflow, and the geopolitical landscape is no less threatening. And shares of European defence firms have not been hit as hard as those in America. Having largely missed out on Mr Bush's party, they are facing less of a hangover now. But with a military budget almost as big as the rest of the world's combined, even quite small changes in American defence spending have big consequences for the industry. Military spending moves in long cycles. After ten fat years, some lean ones are in store.

Technology

Six years in the Valley

Mar 19th 2009 | SAN FRANCISCO
From The Economist print edition

Our correspondent in Silicon Valley looks back before moving on to a new beat

IN 2003, when your correspondent arrived in Silicon Valley, a common response to “How is the Valley?” was “In a nuclear winter.” The dotcom bust had incinerated an entire generation of start-ups. A much-debated essay argued that “IT [information technology] doesn’t matter.” The Valley itself seemed to matter less.

Its geeks were desperately looking for their “next big thing” and minting neologisms (“utility computing”, “the digital home”) in the hope that one might stick. But ordinary people outside the Valley were no longer paying attention. Valley geeks were already hopping onto Wi-Fi hotspots and playing with “smart” phones, but most people were still dialling up to connect to the internet and using mobile phones only for talking. There was some excitement about a fairly new gadget, Apple’s iPod, but nobody suspected that its progeny, in the form of a phone, might one day make the internet “mobile”. Nor did a popular search engine, Google, show signs that it might be a lucrative business, much less a new technology superpower. It was still a world of personal computers, dominated by Microsoft through its Windows operating system.

But towards the end of 2003 two conference organisers, Dale Dougherty and Tim O’Reilly, were brainstorming when Mr Dougherty used the words “Web 2.0”. They immediately realised that the phrase—with its software connotation of a newly released, better and more stable version—had enormous appeal as a rallying cry for the Valley. The Web 2.0 Conference was born, and the first one, in San Francisco in October 2004, created a stir.

It took place shortly after the first big initial public offering (IPO) of a technology firm since the dotcom boom. Google’s IPO did not just announce the Valley’s return to Wall Street. It also unveiled a new business model. When Google at last revealed how much money it was making by placing small, targeted text advertisements next to search results, jaws dropped. Overnight, every entrepreneur had a new one-word pitch to venture capitalists: advertising.

Google became the Valley’s new champion. Its share price soared, it entered new areas almost weekly—from e-mail to maps, from radio to newspaper advertising—and it started buying start-ups, thus replacing the stockmarket as the preferred “exit strategy” for entrepreneurs. Yahoo!, Microsoft and other rivals could not keep up.

Having popularised the term “Web 2.0”, meanwhile, Mr O’Reilly started fretting that it had become a cliché, and was being applied to so many things that it was in danger of becoming meaningless. He tried hard to give it a definition. And so Web 2.0 came to encapsulate several trends that had been going on all along. One was the shift from individual computers as the “platform” for applications to the web as a whole. Residing on the web, these new applications and services inherently lend themselves to collaboration, sharing and participation.

A new boom began, with telltale signs of frivolous start-ups but also the long-hoped-for succession of next-big-things. Each year saw at least one: MySpace, an online social network soon bought by News Corp, a media giant; Flickr, a photo-sharing site snapped up by Yahoo!; YouTube, a site for sharing amateur videos, quickly bought by Google; Facebook, the most innovative social network yet and so far fiercely independent; and now Twitter, a social-messaging service.

People began adopting new habits very fast. Wi-Fi became widespread in homes, offices and universities, and hotspots popped up in cafés, hotels and airports, allowing nomadic workers to go online many times a day, in many different places. Apple launched the iPhone, which upstaged even the BlackBerry in bringing the web, and Web 2.0 applications, to mobile phones, accessible all the time and everywhere. As social animals, people began expecting permanent “connectivity”.

Gadflies began pointing to excesses. Jaron Lanier, a Valley pioneer, saw behind the Web 2.0 totem of

“collective intelligence” an insidious “digital Maoism” that suppressed individuality. Linda Stone, a former Apple and Microsoft executive, observed an unhealthy trend towards “continuous partial attention”, as people spent less time focusing on a single thing or person because they were constantly scanning so many other things—from Facebook to e-mail and their phones—for fear of missing out on some social opportunity.

Perhaps most dangerously, Web 2.0 still had only one business model, advertising, and the Valley was refusing to admit that only one company (Google) with only one of its products (search advertising) had proved that the model really worked. The older internet firms, Yahoo! and AOL, were doing their best to grab a piece of the action. But the “next big things” were selling negligible advertising, often on one another’s sites. Not one of them has become an advertising success in its own right.

And so, as this correspondent prepares to leave, the Valley again finds itself in a curious position. It has been a boon to the world, helping people keep abreast of acquaintances on their social networks, wherever they go, and record and share much more of their own lives. But the Valley stands on ground that is as unstable, seismically and metaphorically, as it was in the earlier bust. Another bubble—this time, not of the Valley’s making—has burst. The world economy is in crisis, advertising is collapsing and start-ups are once again vanishing into thin air. Silicon Valley may be entering another nuclear winter.

Face value

Cheap, but not nasty

Mar 19th 2009
From The Economist print edition

Reuters

In AirAsia, Tony Fernandes has created an airline in his own image

IN 1976 Tony Fernandes, aged 12, found himself being put on a plane to London from Kuala Lumpur by his father, who wanted his son to become a doctor and had enrolled him at a fancy boarding school associated with the medical profession. Mr Fernandes did not become a doctor. Instead, his father's decision to send him to school in London ended up shaping his career in a rather different and unexpected way. When his pleas to be allowed home at half-term were rejected because of the cost of the flight, the young Mr Fernandes opted for what seemed like the next best thing: hanging out at Heathrow airport at weekends, planespotting. Unlike most boys of his age, Tony was not very interested in becoming a pilot. Inspired by Freddie Laker's heroic efforts to launch his SkyTrain service to America, Mr Fernandes decided that what he really wanted was his own low-cost airline.

This month AirAsia X, the long-haul sister of AirAsia, the airline acquired by Mr Fernandes in 2001, began a five-day-a-week service from Kuala Lumpur to London, with an average ticket price of £179 ($250). AirAsia X's first plane, an Airbus A330, was christened "Semangat Sir Freddie" (Spirit of Sir Freddie)—both a tribute to a fellow aviation entrepreneur and a reminder that few budget long-haul airlines have survived for very long.

Mr Fernandes has finally achieved his boyhood dream, albeit by an unusual route. After graduating from the London School of Economics with a degree in accounting, he spent 14 years in the music business, working first for Richard Branson's Virgin Records and then running Warner Music in his native Malaysia. Deeply apprehensive about the merger between Time Warner and AOL in 2001, Mr Fernandes left Warner Music soon after the disastrous deal was finalised, cashing in his shares just in time. Returning to London, he happened to see a television interview with Stelios Haji-Ioannou, the founder of easyJet. The next morning he took himself off to easyJet's base at Luton airport to see, at first hand, how the no-frills airline operated. The next day he returned with a video camera. If easyJet could make money flying people from Luton to Barcelona for £8, he asked himself, could he transplant the same model to Malaysia?

Already Mr Fernandes was thinking about applying the low-cost approach to long-haul—he even went to see GE Capital, to ask if he could lease a Boeing 747. But on the advice of Conor McCarthy, a hard-nosed former head of operations at Ryanair, he agreed to start with a short-haul business. To that end, he approached Malaysia's then prime minister, Mahathir Mohamad, in June 2001 to see whether he would get official backing for his plan to challenge Malaysia Airlines's local monopoly. The canny Mr Mahathir said that he would grant his blessing, but on condition that Mr Fernandes took over an existing airline: AirAsia, a struggling subsidiary of a government-owned conglomerate.

AirAsia had a couple of elderly Boeing 737s, 40m ringgit ($11m) of debt and not much else. Mr Mahathir

told Mr Fernandes he could have it for one ringgit. The deal was signed just three days before the world's airline industry was convulsed by the events of September 11th. By putting in the money from his Time Warner shares, remortgaging his home and bringing in a handful of outside investors, including Mr McCarthy, Mr Fernandes scraped together just enough working capital to run the business, but only if it could be made profitable from the first day.

There was no shortage of sceptics. Not only did it seem to be a terrible time to be starting out, but it was also widely assumed that the low-cost model would not work in Asia, where customers expect high levels of service. Mr Fernandes, however, reckoned that Asia would be spared the worst of the downturn and that he could take advantage of good deals on aircraft that other airlines no longer wanted. He was also convinced that the offer of ticket prices 50% below those of his rivals would speak for itself.

So it proved. In its first full year of operation, AirAsia carried just over a million passengers. This year, with its associate airlines in Thailand and Indonesia, it expects to fly 22m passengers (or "guests", as Mr Fernandes calls them). The number of destinations it serves has risen from six to 110. With a nearly all-Airbus fleet of 80 aircraft and 175 more A320s on order, AirAsia has become one of the European planemaker's best customers. AirAsia X, in which Mr Fernandes's old boss, Mr Branson, has a 20% stake, wants 25 of the new A350s to add to the handful of A330s and the (London-bound) A340 it already operates. As well as the new London route, it flies to Australia, China and India. Unlike other long-haul budget operators that have crashed and burned, AirAsia X has the advantage of economies of scale with its short-haul sister airline, which also acts as a regional feeder network.

Doing it differently

AirAsia has been profitable for all but the second half of 2008, when Mr Fernandes decided to unwind fuel hedges before most other airlines took the plunge. After taking an initial hit, AirAsia is now getting the full benefit of oil at $40 a barrel while some rivals are still paying $100. That decision is typical of Mr Fernandes's willingness to break ranks. When other airlines slashed advertising during the SARS scare in 2003, AirAsia tripled its spending.

Mr Fernandes says that he came to the industry with no preconceptions, but found it rigidly compartmentalised and dysfunctional. He wanted AirAsia to reflect his own unstuffy, open and cheerful personality. He is rarely seen without his baseball cap, open-neck shirt and jeans, and he is proud that the firm's lack of hierarchy (very unusual in Asia) means anyone can rise to do anyone else's job. AirAsia employs pilots who started out as baggage handlers and stewards; for his part, Mr Fernandes also practises what he preaches. Every month he spends a day as a baggage-handler; every two months, a day as cabin crew; every three months, a day as a check-in clerk. He has even established a "culture department" to "pass the message and hold parties".

General Electric

Losing its magic touch

Mar 19th 2009
From The Economist print edition

The credit crisis and recession have claimed GE's coveted credit rating. What does the future hold for America's venerable conglomerate?

Illustration by Brett Ryder

AMONG the many works that lionise General Electric (GE) as a model of management excellence is one entitled "If Harry Potter Ran General Electric", which claims to draw lessons for managers from J.K. Rowling's tales of the boy wizard. The book is unlikely to rival the original Harry in the bestsellers' chart. But its title might just appeal to shareholders of the American industrial giant, who have watched aghast as their company has fallen under a particularly nasty spell.

Since the turn of the year GE has slashed its dividend by two-thirds, lost a prized AAA credit rating on its long-term debt and seen its stock battered by speculation about the quality of some loans made by its huge financial-services division, GE Capital. Some analysts have portrayed this business as GE's very own chamber of horrors. On March 19th, after *The Economist* had gone to press, GE was due to reveal more details of the contents of GE Capital's asset portfolio in a bid to quell concerns about problems within.

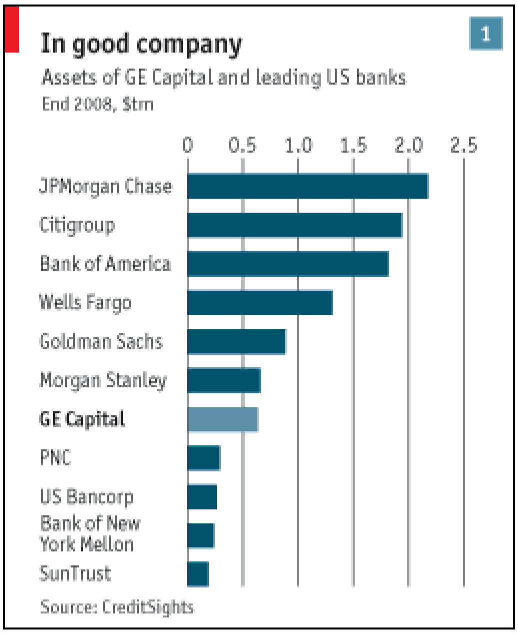
These setbacks have been deeply painful for a 130-year-old company that has been a member of the Dow Jones Industrial Average since 1896. As well as underlining the importance of swift action to right GE Capital, they also raise big questions about the future of the conglomerate model that GE has long championed. And they have exposed mistakes by the company's senior managers.

How did GE get itself into a mess that has seen $269 billion wiped off its stockmarket value since the beginning of 2008? The main reason is that the strategy which helped GE gain its reputation for consistently producing bumper profits, year in and year out, has backfired. At its core was GE Capital. Founded in 1932 as General Electric Contracts Corporation to provide financing that supported the group's industrial businesses, the operation gradually expanded into other areas of lending unrelated to GE. Under Jack Welch, GE's chief executive from 1981 to 2001, GE Capital grew rapidly.

Although Mr Welch has recently argued that it is a "dumb idea" for managers to become obsessed with short-term profit goals, during his reign GE made Herculean efforts to hit its quarterly earnings targets. If

GE's industrial businesses fell short of the mark, the company's finance arm would stage a last-minute sale of assets to close the gap. "GE used GE Capital like a cookie jar" into which it dipped when needed, says James Schrager, a professor at the University of Chicago's Booth School of Business.

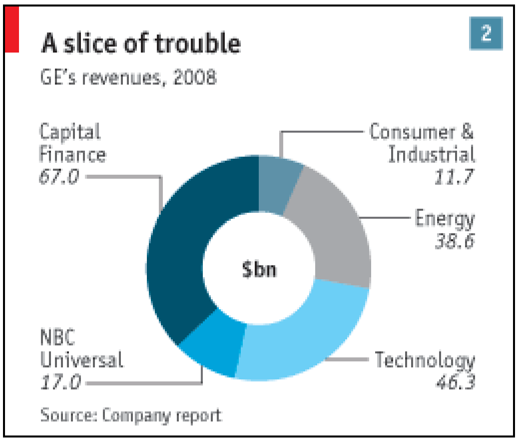
Jeffrey Immelt, Mr Welch's successor, sold some of GE's financial operations, including its poorly performing insurance businesses. But he continued to expand GE Capital, which built up large portfolios of property loans, credit-card debt and other assets in increasingly far-flung places, such as eastern Europe. If GE Capital were a bank, it would rank as one of the biggest in America (see chart 1). Its growth has made the division more and more important to its parent's overall revenues and performance (see chart 2). In 2007 GE Capital's profit made up 55% of the company's total.



GE's managers were delighted with this. But they failed to appreciate the risk of GE Capital's funding model, which left the business dangerously exposed to disruption in financial markets. With few retail deposits to speak of, the firm gorged on long-term debt and commercial paper to fund its lending. While the world was awash with credit, these cheap funds provided GE Capital with a licence to print money. But when the credit markets suddenly seized up, the strains soon began to show. In April 2008 GE shocked investors when it missed its first-quarter earnings target by a mile.

Since then, GE has been battling to shore up confidence in its financial arm. Among other things, GE Capital has tapped cheap funding lines backed by the American government and has greatly reduced its exposure to the short-term commercial-paper market. It has also secured more than 90% of the long-term debt that it needs for the year.

At the same time, GE has been building up cash, some of which has been deployed to prop up the finance business. Last October the firm raised $15 billion from a group of investors including Warren Buffett's Berkshire Hathaway. In February it said it would slash its quarterly dividend by 68% from the second half of 2009 in order to conserve $9 billion of cash on an annual basis. The dividend cut was a bitter blow for small investors who had come to view GE stock as tantamount to an annuity. It was the first time the firm had reduced its dividend since 1938.



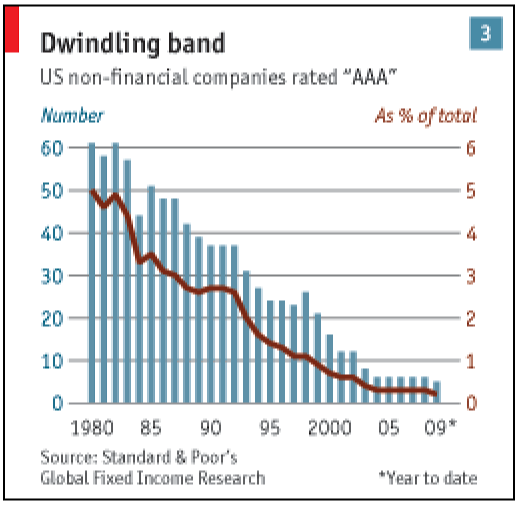
Out of the club

Despite all this, GE failed to save its top-notch credit rating. On March 12th Standard & Poor's (S&P) stripped the parent company and GE Capital of their AAA long-term ratings, downgrading them to AA+. A mere five non-financial companies still have the agency's top rating (see chart 3). GE had been in the elite since 1956. Some expect its rating to slide further this year as the economy worsens. GE Capital clocked up $12.2 billion in 2007 and made $8.6 billion in 2008. Analysts, predicting write-downs, have been doubting whether it will make a profit of $5 billion in 2009, as its parent forecast earlier this year.

At this week's meeting GE was due to lay out for analysts the prospects for GE Capital's portfolio under two different economic scenarios. The company was expected to say that, under the less auspicious of these, GE Capital would only break even this year.

Given the unit's difficulties, it would be understandable if Mr Immelt wanted to jettison GE Capital as soon as it has been nursed back to health—which may take a while. But he insists he is committed to the business, which he says has strong franchises in areas such as aviation and energy finance, thanks to its close association with GE's industrial activities. The goal is to shrink the financial-services division so that it represents no more than 30%

of GE's profit, to reduce its leverage and to develop a bigger deposit base, so that it is less reliant on wholesale funding.



There are two risks with this plan. The first is that investors will remain leery of GE's stock for as long as the company owns a sizeable business that is vulnerable to a systemic upset in the financial world. Shrinking it would lessen the threat to GE's cash-pumping industrial operations, but not remove it altogether.

The second risk is that tomorrow's finance is going to look very different from today's. GE Capital flourished as a member of the "shadow banking" system of firms that offered myriad financial products without having to bear the regulatory burdens of banks. In future, firms that perform bank-like activities can expect much stricter oversight, whether or not they have a banking licence. That will impose greater costs on the business. And if GE Capital's credit rating continues to slip, raising its funding costs, it will find it much harder to turn a decent profit. GE reckons that a shrunken finance operation can achieve a 15% return on investment. However, this may be wishful thinking.

Imagine, though, that Mr Immelt changed his mind and decided he would like to be rid of GE Capital. To say so now would be foolhardy, because this would trigger speculation about the unit's longevity as a stand-alone business, possibly unnerving its counterparties and sending more shockwaves through the financial system. There would also be huge legal, tax and other headaches to contend with—assuming Mr Immelt could find a buyer. But if GE's repair job were complete and the credit crunch a distant memory, there would be fewer hurdles to a sale.

Whatever the ultimate fate of GE Capital, a bigger question remains: does GE itself still make sense? The justification for a conglomerate is that in difficult times its broad selection of businesses should enable it to maintain profitability when its more specialised rivals struggle. GE's hybrid industrial-financial model was supposed to be a superior version of the type.

Yet by Mr Immelt's own admission, GE's reputation as a safe port in an economic storm has been "tarnished". Although the company made a profit of \$18.1 billion in 2008, this was nearly 20% less than in 2007. This year is likely to see another sharp decline. Aside from the problems at GE Capital, several of GE's other businesses, such as media and health care, are having a torrid time. Nicholas Heymann of Sterne Agee, a stockbroking firm, reckons that GE's health-care business could see earnings drop by 25-30% this year as its customers suffer budget cuts.

Under the charismatic Mr Welch, the firm focused on cutting fat and boosting efficiency, and used the cash generated to go on a shopping spree, building leading positions in industries such as energy and transport. He also sold a number of ailing businesses. But by the time Mr Immelt became chief executive on September 7th 2001, just four days before the terrorist attacks on New York and Washington, it was clear that GE needed to change direction. For one thing, its rivals had aped many of the efficiency-boosting management tools that had once given GE an edge. For another, the rise of deep-pocketed private-equity firms had created stiff competition in buying top-notch assets.

Mr Immelt, recognising that the world has changed, has placed more emphasis on organic growth since taking office. He has built up the company's marketing expertise, whereas in Mr Welch's GE engineers and spreadsheet jockeys were the masters. And he has focused on innovation. Since 2001 GE has invested \$330m to expand its research facilities around the world. It spent \$4.3 billion on R&D in 2008, up from \$2.3 billion in 2002.

In a bold initiative, "Ecomagination", GE is aiming to dominate the market for clean technologies such as wind and solar power. By lifting its investment in clean-tech R&D to \$1.5 billion a year by 2010, the company hopes to produce more ideas like its hybrid diesel-electric locomotive, which stores the energy dissipated during braking in batteries that can be called on to power the engine later. Such ideas have boosted organic growth in GE's industrial businesses to 8% in 2008 from 4% in 2001.

Illustration by Brett Ryder

The firm has also dumped a number of its underperforming operations and made acquisitions in promising areas such as Hispanic media and clean technology. Altogether, GE has snapped up about \$101 billion of assets since 2001 and disposed of \$53

billion of businesses. Now looks like the time to pick up more high-quality targets on the cheap. Given the problems with GE Capital, however, the company is likely to think twice before splashing out. Mr Immelt and his lieutenants have repeatedly stressed in recent weeks that their number one priority is to keep the company "safe and secure".

Here lies the rub. One tenet of the conglomerate model is that a judicious mix of businesses should offer insurance against the worst ravages of a recession, leaving enough capital free at the corporate centre to support expansion when rival firms are pulling in their horns. Yet GE Capital's problems are so great that the priority now for its parent seems to be to hoard as much cash as it can.

So does this mean that GE should be broken up? Assuming the company can revive GE Capital, there might be a case for hanging on to that business even if its margins are squeezed. By refocusing on its original mission, a stripped-down finance unit could help drive sales at GE's industrial operations by providing finance for large infrastructure projects and other activities. But investors would need cast-iron reassurance that the business would be kept out of the freewheeling activities in which it has come a cropper.

The case for keeping the rest of GE together, at least for the time being, is based on three arguments. For a start, the company's leaders deserve more time to show that their R&D investments can pay off as the economy recovers. Next, in a world in which governments will become bigger customers for GE's wares, thanks partly to huge fiscal stimulus packages, the company's expertise in dealing with public authorities should benefit all of its divisions. Given GE's strength in areas such as clean technology, energy and transport, it stands to benefit from at least some of the public money that will be up for grabs.

The third argument in favour of keeping GE's industrial side intact is that it has learnt how to sell its disparate wares to foreign governments in compelling combinations rather than one by one. Last year, for example, GE signed a wide-ranging partnership with Mubadala, the commercial-investment arm of Abu Dhabi, which included a joint venture in commercial finance, some renewable energy projects and a new GE training centre. The company also struck deals in China, connected to the Beijing Olympic games, that generated $2 billion of revenue. At a time of rising protectionist sentiment, GE's ability to assemble such packages could ease its path into new markets.

In his annual report to GE's shareholders, which was published last month, Mr Immelt argued that so long as the company could get itself through the recession, it would benefit as global capitalism was "reset" in some of the ways outlined above. To weather the cycle, GE's management plans to keep cutting billions of dollars from its costs, to generate more revenue from its growing business that services turbines, jet engines and other GE gear, and to keep investing in the development of its employees' capabilities, on which it spends $1 billion a year.

Fallen heroes

GE prides itself on being a breeding ground for exceptionally talented managers. That is likely to remain true. Its industrial businesses are basically well run, even though recession will be a drag on their results. Yet the company's halo has slipped because of the debacle at its finance arm. Given the precarious nature of GE Capital's funding structure, GE should have been alert to the risk of a complete dislocation in financial markets. But it failed to consider such a possibility. The firm says it now plans to give a greater voice to contrarian types within its ranks, who can play devil's advocate in planning meetings.

GE was not the only blue-chip company to be caught out by the speed with which credit markets shut down. But it made matters worse by being slow to reveal details of GE Capital's loan portfolio. Instead it tried to persuade investors that the business could ride out the storm, without giving them enough information on the contents of the finance arm's black box of assets. This sparked wild speculation about the state of GE Capital's balance-

sheet, undermining GE’s share price (see chart 4). “As financial services became more volatile, we should have given more transparency and less guidance,” admits Mr Immelt.

The chief executive has paid personally for GE’s poor performance. At his own suggestion he is going without a bonus for last year (though he was paid a salary of $3.3m). For 2007 he scooped $5.8m. Mr Immelt has also given up a special, three-year, long-term incentive payment that would have been worth $11.7m.

Some critics claim that GE’s boss has dented his credibility by making several optimistic predictions that have been quickly proved wrong. For instance, barely a couple of weeks before the company revealed that it had missed its earnings in the first quarter of 2008, Mr Immelt declared that he expected GE to hit its target. In September he denied that the company needed a fresh capital injection. But soon afterwards it announced that it had raised $15 billion from Mr Buffett and others.

Mr Immelt argues that he had to reverse course swiftly in the autumn because financial markets suddenly took a turn for the worse. “What you don’t want to be is a consistent but dumb guy,” he says. He has a point: had GE not moved fast to build up its finances then it would certainly be in a far worse predicament now. Nevertheless the suspicion lingers that GE’s boss has a habit of promising too much. The best way for him to rebuild confidence in his leadership will be to demonstrate that GE can bounce back quickly from its woes. It will require a prodigious feat of managerial wizardry to pull that off.

American International Group

Cranking up the outrage-o-meter

Mar 19th 2009 | NEW YORK
From The Economist print edition

The outcry over bonuses at AIG is complicating efforts to stabilise America's financial system

Illustration by Peter Schrank

THIS crisis has brought a burst of creativity in the development of indicators of pain, from the subprime implode-o-meter to the downgrade-o-meter for structured securities. Perhaps it is time for the outrage-o-meter. Its needle would have jumped off the scale this week as America's public, politicians and media huffed and puffed over the $165m in bonuses paid to members of the financial-products division that brought down American International Group (AIG). Troubles in that unit have forced the government to bail out the giant insurer, so far to the tune of $173 billion.

AIG's wayward eggheads are not the only ones squirming. The affair is a test of the Obama administration's handling of financial excess—and so far it has been ham-fisted. After flip-flopping over whether it had the authority to meddle with employment contracts, the Treasury eventually seized on a clause in the recently passed stimulus bill that may allow it to retrieve payments deemed contrary to the public interest. Tim Geithner, the treasury secretary, promised to recoup the money by deducting some of it from the next $30 billion tranche of aid for the company.

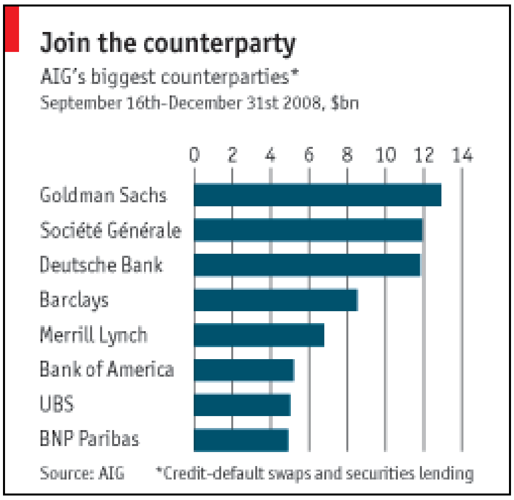
This is unlikely to assuage critics. The employees get to keep the bonuses while AIG is deprived of funds that were supposedly essential to keeping it afloat. The government's back and forth has also damaged the credibility of the Federal Reserve, which has lent heavily to AIG and was aware of the bonuses several weeks ago.

Mr Geithner's hand was forced by an increasingly hysterical Congress. Charles Grassley, a senior Republican, set the tone by suggesting that AIG executives apologise Japanese-style, first bowing and then perhaps committing suicide. The language was no less salty at a congressional hearing on AIG on March 18th, at which the firm's chief executive, Edward Liddy, faced a rough ride despite being in the job only a few months and working for a salary of $1.

As the uproar grew, lawmakers began crafting bills that would impose taxes of up to 100% on the bonuses. Andrew Cuomo, New York's hyperactive attorney-general, entered the fray, slapping subpoenas on the firm and muttering about possible fraud. His office stoked public ire by revealing that 73 employees had received over $1m, and that $57m of its "retention" payments were earmarked for staff it planned to lay off. At the hearing, Mr Liddy said he had asked all those who received more than $100,000 to give back at least half, and that some—no doubt motivated by death threats and the unwelcome attention of paparazzi—had offered to return the full amount. But he also worried that they would leave AIG, making it

harder to manage the toxic financial-products business.

Shocking though the bonuses have been, they pale in comparison with the $49.5 billion of payments that AIG has made to counterparties in its disastrous foray into credit-default swaps—many of them foreign banks (see chart). This was no accident: it was precisely bailing out these trading partners that the government viewed as necessary to avoid a systemic meltdown. Still, the transfers—including almost $13 billion to Goldman Sachs, making it, as one newspaper put it, a “charity case”—are likely to receive more scrutiny as the bonus storm subsides.



The furore over AIG is awkward for the new administration in several ways. First, it makes it harder to pin responsibility for botched financial rescues on the Bush team. The new lot could have nipped the bonus fiasco in the bud. It also leaves Mr Obama walking a fine line between convincing the public that he shares their sense of outrage while also possibly pressing for more rescue funds. The government’s best guess is that another $750 billion could be needed. Insurers are clamouring for funds too. But bail-out fatigue is growing. The hearing’s chairman, Paul Kanjorski, suggested that the AIG mess could force Congress to reconsider any future largesse.

It does not help that Mr Geithner’s star is falling. His failure to get ahead of the problems at AIG follows his botched unveiling of a bank-rescue plan. Regaining his credibility will depend on the success of two new schemes: one to boost consumer lending by reviving securitisation, and another to remove toxic assets from banks (details of which are expected any day). Here, too, the government faces a balancing act: it needs to make the terms attractive enough to bring in private buyers, but not so attractive that they invite more political fireworks.

Another risk is that restrictions placed on firms that receive public money backfire. Banks are responding to new executive-bonus limits by increasing salaries. This “flies in the face of making pay more performance-related,” says Pearl Meyer of Steven Hall & Partners, a consultancy. Chafing under restrictions on their activities, recipients of funds from the previous government’s Troubled Asset Relief Programme are scrambling to repay them early. This may cheer taxpayers, but the withdrawal of capital may also hurt lending.

No wonder Mr Obama is keen to move the debate on. The focus now, he said on March 18th, should be on giving the government the tools to prevent a repeat: resolution authority over non-banks, similar to the power the Federal Deposit Insurance Corporation has to shake up sick banks. Mr Liddy, meanwhile, will be urged to earn his dollar by disposing of AIG’s assets and cutting the group’s vast debt to the taxpayer. Such deals have so far proved elusive. This week’s brouhaha is unlikely to make the task easier.

Buttonwood

Swissie fit

Mar 19th 2009
From The Economist print edition

The terrible temptation to depreciate

Illustration by S. Kambayashi

IT IS not easy being Swiss. Every other country complains about your bank-secrecy laws. If you live in Zurich, the nice houses by the lake are taken by rich foreigners and you have to put up with something more modest and farther out.

Worse still, in a crisis, everyone buys your currency, in effect tightening your monetary policy. UBS excepted, Switzerland did not indulge in an Anglo-Saxon-style speculative boom over the past decade. But it is suffering nevertheless. The Swiss National Bank thinks the economy will contract by between 2.5% and 3% this year. Consumer prices are expected to fall by 0.5% in 2009; in other words, the economy is suffering from deflation.

But now, to recall the movie "Network" (featuring a different UBS), the Swiss are mad as hell and they are not going to take it any more. In February residents of the Zurich canton voted to stop foreigners from having the right to pay tax as a lump sum related to the value of their property, rather than having their income and wealth properly assessed in the same way as Swiss citizens do.

The bigger move, however, came on March 12th. The national bank vowed to intervene in the currency markets in order to prevent the Swiss franc from appreciating further against the euro. That made the Swiss the first big economy in the crisis to opt for explicit depreciation. The Swiss have tried before to discourage the use of the franc as a haven currency. Back in the 1970s they charged foreigners a fee for having a bank account, in effect imposing a negative interest rate.

Some analysts argue the Swiss are only doing what other central banks are attempting—boosting the economy by printing money to buy their own government and high-grade corporate bonds, a trick known as "quantitative easing" (see Economics focus). As in other countries, Swiss interest rates were virtually down to zero, so new measures were needed.

But the virtuous nature of Swiss public finances means there are not many domestic government bonds available to buy back. In addition, Mansoor Mohi-uddin of UBS points out, there are only SFr17 billion ($14.4 billion) of domestic non-financial corporate bonds outstanding; that compares with a total money supply of SFr642 billion. Buying foreign bonds (and selling Swiss francs) is thus a logical step to expand liquidity.

Adarsh Sinha of Barclays Capital thinks the Swiss move will not be the start of a tit-for-tat round of devaluations. First, because Switzerland is a small country in terms of global trade, depreciation of the franc will not have a big effect on the competitive position of other countries. Second, Switzerland is a relatively open economy and depreciation will have more effect, when it comes to countering deflation risks, than it would for the United States or the euro zone.

Nevertheless, there are some troubling aspects to the Swiss move. First, Switzerland's current-account surplus is forecast to be 8.7% of GDP this year. Normally, it is deficit countries that need to devalue. How will global imbalances be corrected if surplus countries try to depreciate?

Secondly, to state the obvious, all currencies cannot fall. If the Swiss franc is no longer a safe bet, traders will find something else. They will not all choose gold. If the Swiss were unable to stand the pressure of being a currency bolthole, why should other countries be able to do so?

The question is all the more urgent because many countries face the same problem. Others may be

tempted to argue, like the Swiss, that they have technical reasons to weaken their currencies. In New Zealand, for example, the central bank has lowered interest rates more than five percentage points but the local currency is still appreciating. The economy is probably in its fifth quarter of recession and the Royal Bank of Canada thinks the New Zealand central bank may have to resort to foreign-exchange intervention.

Back in the 1930s many countries had to choose whether or not to abandon the gold standard. Those that did so soonest tended to suffer least during the Depression. In these days of floating currencies, it is no longer necessary to announce a formal devaluation; benign neglect can allow the currency to fall. Some Europeans suspect this has been happening with the British pound.

But it is still a form of subtle protectionism, relying on someone else to take the strain. To raise the most worrying example, Chinese exports are down by more than a quarter from a year ago. What if the Beijing authorities decided that, in order to generate their targeted 8% economic growth, a bit of depreciation was required? After all, what's good for the Swiss...

American banks

Sharing the pain

Mar 19th 2009
From The Economist print edition

As the political climate sours, banks' creditors get nervous

EVEN as America's politicians harangue the bankers, the bankers are sniping back. On March 13th the chairman of Wells Fargo, America's fourth-biggest bank, called the Treasury's ongoing stress test for banks, with its glacial timetable, "asinine". Amid the ranting, the rot from bad debts is creeping up banks' capital structures, imperilling any recovery. Initially common shareholders, who bear the "first loss" on assets, were crushed, along with preferred shareholders, who get supposedly safer dividends. Now owners of bank debt, which bears losses once equity is wiped out, live in fear. Junior subordinated debt, which ranks next in the queue, trades at 15-45 cents on the dollar and senior subordinated debt at 65-70 cents. Even senior debt, holders of which rank second only to depositors in America and typically alongside them in Europe, is at 85-90 cents.

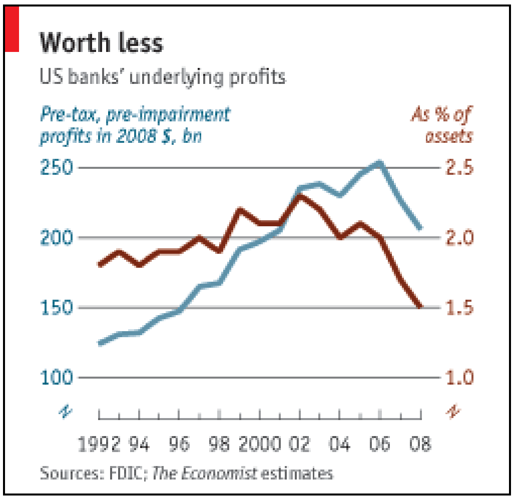
It was not meant to be like this. After Lehman Brothers' chaotic bankruptcy it was judged that big bank failures were too destabilising to tolerate. Hence America's government injected equity into banks to boost the buffer against losses and to end the freeze in wholesale-funding markets that had made banks wary of lending to each other. But now many worry the buffer is too small—hence the suspense over the results of the stress tests, due in late April. Some politicians are losing patience and want creditors to suffer alongside taxpayers. "These banks can go into receivership…reduce the amount they owe to their bondholders, and come back out much stronger institutions," argues Brad Sherman, who sits on the House Financial Services Committee.

Haircuts for everyone, although perhaps emotionally satisfying, remain unthinkable. Bankruptcies would cause chaos among depositors and lenders to banks such as money-market funds, insurance firms and foreign governments. They would also contradict the entire thrust of American policy so far, which has seen the authorities guarantee $210 billion of new debt issued by banks. The state would also lose the $240 billion it has invested in banks' common and preferred equity. Tim Bond of Barclays Capital says the sell-off in senior bank debt is "completely baseless". One response to market jitters would be to guarantee all bank debt, not just the new stuff. But after repeated bail-outs of American International Group, a bottomless pit masquerading as an insurance firm, the Treasury would need to be sure that banks are solvent. Widespread losses by depositors and senior bondholders remain implausible. But the fate of more junior creditors rests on the stress tests, which will assess whether losses can be absorbed in two scenarios, the worst of which projects a further 28% drop in house prices and a 10% unemployment rate by 2010.

Just how far up the capital structure might losses go? A pessimistic estimate of American banks' losses on securities and loans, by two economists, Nouriel Roubini and Elisa Parisi-Capone, points to an incremental hit of $1.3 trillion, on top of the $500 billion American banks have booked so far (which adds up to 13% of GDP). To cushion this $1.3 trillion blow, American banks have left just $700 billion of tangible common equity, the purest and most flexible form of capital. However banks will still make underlying profits before provisions that can help absorb losses. David Hendler, an analyst at CreditSights, a consultancy, points out that low short-term rates helped banks boost their lending margins in the fourth quarter of 2008. And this month many big lenders have made positive noises about profits so far this year. Stockmarkets have surged in response.

Based on hints from Bank of America and JPMorgan Chase, which suggest they will make annual pre-provision profits of just under 2% of assets this year, in the best case America's banks would sustain the underlying earnings level of recent years (see chart). Bears, however, think profits will collapse as loan books shrink and capital-market activity withers. Simon Samuels of Citigroup reckons banks' pre-provision profits fell to 50% of their peak level in America during the Depression (compared with 35% after Japan's banking crisis and about 20% after Sweden's). Added to

tangible common equity, the best and worst case scenarios for earnings over the next three years suggest a buffer of $1.1 trillion-1.6 trillion. Compared with incremental losses of $1.3 trillion, that is too tight.



Ideally banks' balance-sheets would have another type of capital which could top up the buffer without spooking depositors or the owners of senior debt and senior subordinated debt. Fortunately that capital exists. American banks have $440 billion of hybrid tier-one capital, in addition to tangible common equity. Much of this is in preferred shares, but there is also about $100 billion of junior subordinated debt at the ten biggest banks alone. This is typically long-dated with deferrable coupons—which is why regulators treated it as tier-one capital. The trick will be to convert this into common equity without putting banks into administration. Given the threat coupons will be suspended for the foreseeable future, and the low prospects for redemption, prices on this debt have tumbled to 15-45 cents. More banks may try to tempt owners to convert it, as Citigroup has proposed with up to $28 billion of its preferred shares and tier-one hybrid debt.

If American banks were to convert all of their tier-one capital into common equity, then after bearing all losses, the available tangible common equity buffer in three years' time would trough at between 2% and 5% of assets. Providing profits continue to roll in, that could be just about acceptable, particularly if the government's plan to buy toxic assets also finally gets off the ground. Some banks may fail the stress tests—and if they do the political climate may demand that more senior creditors suffer. But it looks just about possible that America's banking system can stagger on without defaulting. In God, and in the squashing of hybrid capital, do senior bank creditors trust.

Financial regulation

Top watchdog

Mar 19th 2009
From The Economist print edition

Should the Fed take up the cudgel as America's regulator in chief?

ON GLOBAL regulation, America is usually seen as the foot-dragger. Tim Geithner, the treasury secretary, sought to dispel this impression on March 14th, telling his Group of 20 counterparts he wanted "a much stronger form of oversight and clear rules of the game".

Credit this change of heart to the bruising experiences of the last year. On March 17th he reminded Congress of the need for an expanded resolution authority so that regulators could take over any systemically important financial institution, pay off its creditors and sell its assets, even if it were not technically a bank as was the case with Bear Stearns, Lehman Brothers and American International Group (AIG). He also wants to create a "systemic risk regulator", empowered to snoop into the secretive areas of finance, such as hedge funds, imposing safety measures, such as capital requirements, where necessary.

Administration officials appear to favour the Fed for this role. So does Barney Frank, chairman of the House Financial Services Committee, though he says political support for the idea has been hurt by the Fed's handling of AIG.

But there are many questions over the merits of a systemic-risk regulator. First, could it hope to forestall a crisis? None of the banks foresaw today's mess, even though their survival was at stake. Regulators, meanwhile, looked the wrong way: they were far more worried by hedge funds than subprime mortgages. That tends to be typical.

Second, which institutions would be covered by the new regime, how would they pay for the privilege (if at all), and would they then be viewed as too big to fail? Peter Wallison of the American Enterprise Institute, a think-tank, worries that those most closely scrutinised could borrow more cheaply, squeeze out competitors, and eventually become as risky as Fannie Mae and Freddie Mac, the two giant mortgage agencies.

Third, is the Fed right for the job? Its own regulatory record is unimpressive: it was Citigroup's principal regulator. Its new duties could draw it into political fights that could compromise its independence. They may also conflict with monetary policy; it may keep interest rates low to prevent a firm from failing, though that could risk stoking higher inflation.

On the other hand, as the lender of last resort only the Fed can inject money into virtually any type of firm; it might be good to give it corresponding authority to prevent abuse, too. Moreover, the Fed's regulatory record is not the worst. AIG, for example, owned a tiny thrift which meant that the parent and the unit that produced its derivatives book were overseen by the Office of Thrift Supervision. The OTS also supervised the two biggest banks to fail so far: IndyMac and Washington Mutual. Such cases suggest that banks shop for the friendliest regulator (though the OTS disputes that). Adding one more—even an overarching one—may do little good unless the whole regime is streamlined.

House prices

Caught in the downward current

Mar 19th 2009
From The Economist print edition

The global housing market goes from bad to worse

WHEN we last looked at global house prices, only six of the countries we surveyed had recorded year-on-year declines. Three months later that figure has risen to 16.

In America some saw signs of a bottom in a report on March 17th showing sharp rises in housebuilding starts and permits in February, after months of decline. Others, however, just saw a bigger stack of apartments for sale which no one will be very keen to buy. In truth, the outlook has long been dismal from the banks of the Potomac and the Thames, and now it is starting to look grim from the banks of the Huangpu.

Gone is the optimism of yesteryear. Book titles such as “Are You Missing the Real-Estate Boom? The Boom Will Not Bust and Why Property Values Will Continue to Climb Through the End of the Decade — And How to Profit From Them” (2005) are destined for the annals of folly, next to asset-bubble classics such as “Dow 36,000”. Fear has replaced frenzy, and house prices may overshoot on the way down. A recent report by Numis Securities estimated that British house prices could fall by a further 40-55%, saddling millions with properties worth less than their mortgage debt. Long was the uphill march, long will be the downhill descent.

***The Economist's* house-price indicators**
% change

	Latest	Q4 2007	1997-2008*
	on a year earlier		
Switzerland	3.7	2.0	24
Italy	1.1	5.1	104
France	0.8	5.7	152
China	-0.9	10.2	*na*
South Africa	-1.3	12.2	389
Sweden	-1.6	11.3	145
Japan	-1.8	-2.8	-33
Canada	-1.9	5.9	66
Germany	-2.5	-4.2	*na*
Spain	-3.2	4.8	184
Australia	-3.3	14.0	163
United States *(OFHEO)*	-4.5	0.6	84
Singapore	-4.7	31.2	*na*
Denmark	-4.9	1.2	119
Netherlands	-5.2	2.8	90
New Zealand	-8.9	8.0	102
Ireland	-9.8	-6.0	193
Hong Kong	-14.0	21.4	-35
Britain	-17.6	7.1	150
United States *(Case-Shiller national index)*	-18.2	-8.7	66
United States *(Case-Shiller ten-city index)*	-19.2	-8.3	102

*Or most recent available figure

Sources: ABSA; ESRI; Hypoport; Japan Real Estate Institute; Nationwide; Nomisma; NVM; OFHEO; Quoteable Value; Stadim; Swiss National Bank; Standard & Poors; government offices

German banking

Finance on four wheels

Mar 19th 2009 | BERLIN
From The Economist print edition

Germany’s savers have found a racy place to stash their cash

IN THE land of the autobahn, love for cars and the firms that build them knows no bounds. What’s more, the relationship appears to be for worse as well as for better. For even as car sales slump, German savers are pulling money from their safe, but staid, savings banks and entrusting it to their racy—if ropy—carmakers.

BMW Bank’s deposits have jumped by almost 70% over the past five months. Those at Mercedes-Benz Bank have doubled over the same period and Volkswagen’s financial-services arm ended the year with deposits up by about a third. Banking with car companies is nothing new in Germany. Some big carmakers have been holding money for their customers for over a decade, using the cash to finance car loans and leases. But the recent surge in deposits is a peculiar consequence of the credit crunch in Germany.

Since credit markets froze last autumn, carmakers raising money have had to turn to depositors, rather than banks and wholesale financial markets. “Having an independent bank is a useful source of liquidity when liquidity is scarce,” admits Holger Bachmann, the head of deposits at BMW Bank.

To attract savers, the car companies are having to offer attractively upholstered interest rates. Niels Nauhauser of the consumer-protection agency in Baden-Württemberg reckons that car companies were paying depositors up to 5% in December, more than double the average of 2.2% on cash deposits at savings banks.

But even those prices work out cheaper than raising money from banks or the capital markets. For that, the automakers have regulators to thank. When the German government offered retail-bank customers a guarantee on deposits last October to stabilise the banking sector, it included deposits held with car-company banks, making them no more risky than even the most pedestrian savings bank. Lenders in the capital markets, however, have no such guarantee. They are more influenced by the credit ratings of car-company banks, and many of those face potential downgrades on concerns that a slowing economy will lead to increased bad debts on car loans and a fall in the value of second-hand cars sold at the end of their leases.

There is another more subtle reason why the carmakers may be souping up their financial-service businesses. Potentially, it puts them higher up the government-subsidy queue (a place they are always happy to be). Volkswagen’s banking arm has already been granted €2 billion ($2.6 billion) in loan guarantees by Germany’s bank bail-out fund, though it has not yet drawn them down. Other car companies are understood to be considering applying for similar support for their banking arms. One lesson from the crisis is that the closer firms are to the financial system, the better the chance of receiving a handout. Hence, perhaps, the sort of manoeuvring from the car industry that any German driver would be proud of.

Microfinance

Sub-par but not subprime

Mar 19th 2009 | LONDON AND TOKYO
From The Economist print edition

Lending to the poor has held up well but it is not as safe from the credit crisis as its champions hoped

A GLOBAL credit crisis caused by subprime mortgages is hardly the ideal backdrop for a business making unsecured loans to poor people without a credit history. Yet big microfinance companies, which do exactly that, seem to be in rude health. Mohammad Yunus, the unflappably optimistic founder of Grameen Bank in Bangladesh, a microfinance institution for which he won the Nobel Peace Prize in 2006, is adamant that business remains unscathed. “We have not been touched in any way by the financial crisis,” he said on a recent visit to Japan. “The simple reason is because we are rooted to the real economy—we are not paper-based, paper-chasing banking. When we give a loan of $100, behind the $100 there are chickens, there are cows. It is not something imaginary.”

He is not alone in thinking that microfinance is insulated from the problems of the global economy. Its proponents argue that any similarity with subprime loans is misleading. Microfinance institutions (MFIs) lend relatively small sums of money to people in developing countries to start small, profitable businesses, not to buy overpriced homes. Many of those businesses serve local needs, which has more merit at a time when exports are collapsing. And microfinance’s reliance on peer pressure for repayment must be the envy of any mainstream banker struggling with rising foreclosures and “jingle mail”; delinquency rates are microscopic.

Some MFIs, however, do not enjoy the same isolation that their borrowers do. Many of them are funded internationally. According to the Consultative Group to Assist the Poor (CGAP), a research centre in Washington, DC, foreign-capital flows into microfinance tripled between 2004 and 2006. About half the industry’s funding comes from aid budgets, but the share of private money is growing. The World Bank’s private arm, the International Finance Corporation (IFC) gave 55% more each year to microfinance lenders between 2004 and 2007. MFIs, especially those in eastern Europe and Central Asia, also borrowed from foreign banks. Meanwhile the microfinance portfolios of private investment funds grew from $600m in 2004 to $2 billion in 2006.

Funding from development institutions like the IFC is likely to be stable, but aid budgets are being cut and other sources of funding are threatened, too. Kimanthi Mutua, who runs K-Rep Bank, a big Kenyan microlender, says that in 2007 he fielded calls from prospective investors every couple of weeks. For the past six months he has not had a single call. According to CGAP’s Elizabeth Littlefield, borrowing costs have risen by up to four and a half percentage points in some markets. Foreign-currency borrowers may have exchange-rate fluctuations to cope with. And some global banks are pulling out altogether. Even MFIs that borrow locally may find their banks’ funding is constrained by global conditions.

An even more pressing concern is refinancing existing debt. Most MFIs have loans with one- or two-year tenures. According to the IFC, there is a potential refinancing gap of $1.8 billion over the next 18 months. The IFC and the German government have put together a $500m fund to help microfinance firms with refinancing.

All this, some experts argue, should encourage the institutions to start raising funds by collecting deposits rather than relying on fickle markets or donors. In Africa many MFIs already do this. The slow slog of attracting depositors can be off-putting, however, and may become harder if the crisis deepens. The World Bank estimates that worsening economic conditions could push an additional 65m people under the $2-a-day poverty line. These people—formerly known as the “nearly poor”—were just the sort whose savings deposit-taking MFIs had hoped to target.

The squeeze on credit could expose additional frailties in the microfinance model. Many observers suspect that at least some microfinance loans actually finance consumption, not investment, and that borrowers use new loans from one MFI to pay off their debts with another. As long as new credit is readily available, this strategy works—much as paying off one credit card with another once did in the rich world. But the

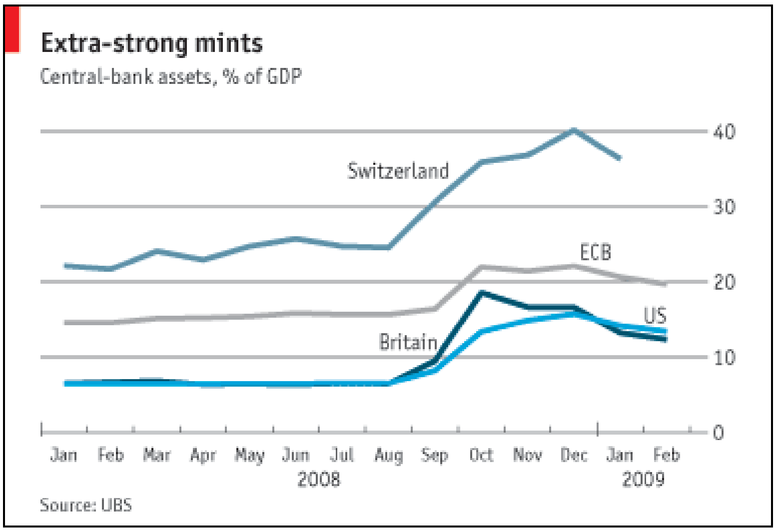
credit crunch may expose this as a problem, reckons Justin Oliver, who runs the Centre for Microfinance, a research centre in Chennai, India. Meanwhile, the IFC reports that data from the top 150 microfinance institutions show that the share of borrowers 30 days delinquent on their loans has increased from 1.2% before the crisis to between 2% and 3% now. This is still very low by most standards and Mr Yunus says that repayment rates at Grameen remain impeccable. But the worry is that a prolonged credit crunch could make microfinance clients start to look more like those hapless subprime borrowers.

Economics focus

Money's muddled message

Mar 19th 2009
From The Economist print edition

Today’s fattened central-bank balance-sheets evoke fears of inflation. Deflation is the bigger worry



BACK in 2002 Ben Bernanke, then still a Federal Reserve governor, declared that “under a paper-money system, a determined government can always generate higher spending and hence positive inflation.” That does not mean it is easy.

On March 18th America’s inflation rate was reported at 0.2%, year on year, in February. The same day the Fed said “inflation could persist for a time” at uncomfortably low levels. Yet some economists and investors insist high inflation, even hyperinflation, is lurking in the wings. They have two sources of concern. The first is motive: the world is deleveraging, ie, trying to reduce the ratio of its debts to income. Policymakers might secretly prefer to do that through higher inflation, which lifts nominal incomes, than through the painful processes of cutting spending and retiring debt, or default. The second is captured by the Fed’s announcement that it plans to purchase $300 billion in Treasury bonds and an additional $850 billion of mortgage-related debt, bringing such purchases to $1.75 trillion in total, all paid for by printing money. It is not alone: around the world, central-bank balance-sheets have ballooned (see chart).

This is scary stuff to those who swear by Milton Friedman’s dictum that “inflation is always and everywhere a monetary phenomenon.” But the role of the money supply in creating inflation is less obvious than monetarism suggests.

The quantity theory of money holds that the money supply, multiplied by the rate at which it circulates (called velocity), equals nominal income. Nominal income in turn is the product of real output and prices. But does money supply directly boost nominal income, or does nominal income affect velocity and the demand for money? The mechanism is murky.

Central banks control the narrowest measure of the money supply, called the monetary base—typically, currency plus the reserves that commercial banks hold with the central bank. But the relationships between the monetary base, broader monetary aggregates and nominal income is highly unstable.

Central banks have mostly given up trying to target inflation via the money supply. Instead, they study the “output gap” between total demand and the economy’s potential to supply goods and services, determined by such things as the labour force and capital stock, as well as inflation expectations. When demand exceeds supply, inflation rises. When it falls short, inflation falls, and in the extreme becomes deflation. To influence demand, the central banks move a short-term interest rate up or down by

adjusting the supply of bank reserves. Changes in the policy rate ripple out to all interest rates paid by borrowers.

The financial crisis has bunged up that transmission mechanism. Risk aversion, fear of default and depleted bank capital have caused private borrowing rates to deviate sharply from policy rates. Central banks have responded by expanding loans to financial institutions, purchasing private securities and buying government debt. They have financed this growth in their assets through increased liabilities such as commercial-bank reserves, swaps with central banks and other ways of printing money.

Is this monetarism? It depends on whom you ask. The Fed calls its policy “credit easing” to emphasise that, though its policy rate is almost zero, it is using different channels to ease credit and boost spending. Even its Treasury purchases are to “improve conditions in private credit markets”. That these actions expand the money supply is secondary. Similarly, the Bank of Japan is buying stocks and may make subordinated loans to banks to boost their capital and lending capacity; the money supply is not a consideration. The Bank of England, on the other hand, calls its purchases of government and private debt “quantitative easing” and explains it in monetarist terms. It expands investors’ holdings of money, encouraging them to shift to other assets, boosting wealth and investment. It acknowledges this may not work. Indeed, merely the news that it would purchase government debt drove down long-term interest rates, just as the Fed’s announcement did, an entirely conventional stimulus to demand. The rhetoric may be different but the policies are largely the same.

If the unprecedented monetary and fiscal stimulus works, output gaps will eventually close. Then central banks will have to reverse their unconventional policies and raise interest rates. They may hesitate in the face of political pressure or an explicit decision to err on the side of inflation rather than deflation. In that case, inflation will rise.

Go forth and multiply

But for the moment deflation is a bigger threat. If the Fed’s current policies fail, fiscal policy can be employed to boost demand. There, too, the Fed has a role: it could buy the bonds needed to finance tax cuts or government spending, thereby limiting the impact on long-term rates. Such debt monetisation evokes fears of hyperinflation. But inflation would result only if monetisation boosted aggregate demand enough to exceed aggregate supply. Laurence Meyer of Macroeconomic Advisers, a consultancy, reckons America’s output gap will reach 9% of GDP by next year. To eliminate that he says the Fed would have to monetise more than $1 trillion of additional stimulus over two years, assuming standard multiplier effects.

The obstacles are primarily political, not economic. Finance ministers are averse to debt and central banks even more so to monetising it for fear of becoming a tool of the government. That aversion is usually healthy but not when deflation looms. The option should be on the table, as long as there are safeguards for the Fed’s independence. Frederic Mishkin, a former Fed governor now at Columbia University, says the important thing is that the Fed, not the Treasury, be the initiator of such purchases, and only after stating that it is consistent with price stability.

On March 15th Mr Bernanke said that the biggest risk facing the economy now is that “we don’t have the political will, we don’t have the commitment to solve this problem.” At least for the moment, it is not the Fed chief’s gumption that is lacking.

Lighting

A brilliant new approach

Mar 19th 2009 | CAMBRIDGE, ENGLAND
From The Economist print edition

Light-emitting diodes will transform the business of illumination, especially with new production breakthroughs

Getty Images

"INCANDESCENT" might well describe the rage of those who prefer traditional light bulbs to their low-energy alternatives. This week, the European Commission formally adopted new regulations that will phase such bulbs out in Europe by 2012. America will do so by 2014. Some countries, such as Australia, Brazil and Switzerland, have got rid of them already. When a voluntary agreement came into force in Britain, at the start of the year, people rushed out to buy the last 100-watt light bulbs. Next to go are lower-wattage bulbs.

But what will replace the light bulb? Although obtaining illumination by incandescence (ie, heating something up) goes back to prehistory, it was not until 1879 that Thomas Edison demonstrated a practical example that used a wire filament encased in glass. Modern bulbs, the descendants of that demonstration, are cheap (around 50 cents) but inefficient, because only about 5% of the energy they use is turned into light and the rest is wasted as heat. A typical bulb also has to be replaced every 1,000 hours or so.

Without changing light fittings, the cheapest direct replacement for an incandescent bulb at the moment is a compact fluorescent light (CFL). These use up to 75% less power and last ten times longer, but they cost around $3 each. That price puts some people off, which explains part of the hoarding of incandescent bulbs. But others object not to the price but to the quality of the light, which has a different spectrum from the one they are used to. CFL bulbs can also be slow to reach maximum illumination. And some people worry that they may be bad for the health. Fluorescent lights use electricity to excite mercury vapour. This produces ultraviolet light that causes a phosphor coating inside the bulb to glow. The lights can flicker, which could set off epileptic fits, and badly made ones might leak ultraviolet radiation, and may thus pose a cancer risk. There are also concerns about the disposal of the toxic mercury.

Light-years

The most promising alternatives are light-emitting diodes (LEDs). An LED is made from two layers of semiconductor, an "n-type" with an excess of negatively charged electrons, and a positive "p-type" which has an abundance of "holes" where electrons should be but aren't. When a current is applied across the sandwich, the electrons and holes team up at the junction of the two materials and release energy in the

form of light. The colour depends on the properties of the semiconductor, and these can be tuned to produce light that is similar to natural daylight but with virtually no ultraviolet or heat.

Light-emitting diodes have progressed from simple red indicators on electronic products to become torches, streetlights and car headlights. Now the first mains-voltage LEDs designed as direct replacements for incandescent bulbs are arriving on the market. Some, such as the Philips Master LED range, promise energy savings of up to 80% and a working life of 45,000 hours. But they are not cheap: around £40 ($56) in Britain.

Even so, LEDs can still be economical. Only a quarter of lighting is domestic. Businesses and public organisations are more aware of running costs than householders are—and besides the electricity bill they also have to pay people to change bulbs that have failed. For the bulbs to be embraced by households, though, LED costs will need to come down.

Manufacturing efficiencies, as always, will help. But the biggest cost reduction will come from breakthroughs like that recently made by the Centre for Gallium Nitride at Cambridge University, England. Gallium nitride is a semiconductor used to create bright-blue LEDs. These can be made to emit white light by coating the device with a phosphor compound that absorbs part of the blue light and re-emits it as yellow. When combined with the rest of the blue this forms a cool, white light. Most of the white LEDs now on the market are based on gallium nitride.

At present these LEDs are made in machines similar to those used to make silicon chips, by depositing layers of gallium nitride on sapphire-based wafers. Sapphire is robust enough to withstand a process that first heats it to 1,000°C and then cools it to room temperature without causing cracks and other defects. It is, however, quite expensive. What Colin Humphreys and his colleagues at Cambridge have come up with is a reliable way to deposit gallium nitride on much cheaper silicon wafers, which they estimate could cut production costs to a tenth of what they are at the moment.

Because the atomic lattice structure of gallium nitride is better matched to sapphire than it is to silicon, making LEDs on silicon without distortions has proved extremely tricky. The technique used at Cambridge involves depositing additional layers of gallium nitride-based materials, one as a “compression layer” to provide greater resilience and another as an ultra-thin mask that increases the accuracy of fabrication. The important measure of success is the internal quantum efficiency, which shows just how good an LED is at making light. A gallium nitride LED on sapphire has a typical internal quantum efficiency of around 70%. In the past year, Dr Humphreys’s team has improved its silicon-based ones from 15% to 45%.

They will get better still, reckons Dr Humphreys. Yet even at this early stage he thinks gallium nitride-on-silicon LEDs would make commercial sense. Besides the lower cost of silicon, the process could also use larger and more economical six-inch (15cm) wafers and be carried out with more common fabrication equipment.

A number of companies are working with Dr Humphreys to commercialise the process. The techniques employed might also help to improve LEDs that produce white light by mixing red, green and blue emitters. These can be modified to produce different colours of light, too, but they have not taken off quickly because they can be hard to package. It is also difficult to maintain consistent outputs from the different LEDs so light from the devices tends to drift into off-white hues.

Developments like the use of cheap silicon make the case for switching to LED lighting even more compelling. About 20% of the world’s electricity is used for lighting. America’s Department of Energy thinks that, with LEDs, this could be cut in half by 2025, saving more than 130 new power stations in America alone.

Low-cost LEDs would also bring light to new areas. Philips, for instance, is planning to launch a small solar-powered LED reading light for Africa, where an estimated 500m people live without electricity. The simplest version, which it hopes to sell for less than $15, is designed to allow children to do their homework in the evenings without a candle or smoky kerosene lamp. Bringing down the cost of LEDs this way really will let in the light.

Dinosaurs

Our feathered friends

Mar 19th 2009
From The Economist print edition

Some say that birds are dinosaurs. The truth may be that dinosaurs are birds

THAT birds are the descendants of dinosaurs is now accepted by almost all evolutionary biologists. The clinching discovery was of animals that were clearly dinosaurs, and clearly could not fly, but which had feathers. That did raise the question, though, of why one twig of the great dinosaur tree had developed such strange outer vestments, even before it developed wings.

If a discovery announced in this week's *Nature* has been interpreted correctly, that question is about to get even stranger. For Zheng Xiaoting of the Shandong Tianyu Museum of Nature in Pingyi, China, and her colleagues, are suggesting that it was not just the part of the clan that led to birds that was feathered. What they have found makes it likely that many dinosaurs had something rather like feathers, and that those which did not had lost a primitive characteristic of the group in the way that elephants and hippos have lost most of the hair that is characteristic of mammals.

The crucial discovery comes from a famous fossil bed in Liaoning province. Dr Zheng and her colleagues propose to call it *Tianyulong confuciusi*. The new species belongs to a group of dinosaurs called the Ornithischia. This group, which includes such famous names as *Stegosaurus* and *Triceratops*, is one of the two clades into which the dinosaurs are divided. The other is the Saurischia, whose famous members include *Diplodocus* and *Tyrannosaurus*. The Saurischia also include all the immediate ancestors of birds. Which is why Dr Zheng was stunned to find on *Tianyulong confuciusi* what are conservatively described in her paper as "long, singular and unbranched filamentous integumentary structures". In other words, things than look suspiciously like the central shafts of feathers.

Li Da Xing

Beautiful plumage

Such "protofeathers" have been found on other dinosaurs, but until now those species have, like those that sport true feathers, all belonged to a part of the Saurischia that includes the birds. Yet the split between Ornithischia and Saurischia goes back to the very beginning of the dinosaurs, 80m years before the first birds and about 100m years before *T. confuciusi*. So if the feather-like structures of *T. confuciusi* really have the same origin as feathers, then such structures must have been there from the outset, and be characteristic of dinosaurs as a whole.

Jurassic lark

That does not explain what they were for. A few researchers argue that they were actually internal to the skin, and thus not related to feathers at all. If they really were external, the most likely answer is that they served the same function—insulation—as hair does on a mammal. But they may, like hair and modern feathers, have had a secondary, signalling function.

This discovery raises another question, too. Taxonomically, the very definition of a bird was until recently an animal that has feathers. Now, taxonomists argue that since birds are descended from dinosaurs they should be classified merely as a subgroup of the Dinosauria. But if feathers truly are the diagnostic criterion, then perhaps things should be the other way round, and *Stegosaurus*, *Triceratops*, *Diplodocus*, *Tyrannosaurus* and their kin should no longer be thought of as terrible lizards, but as overweight, flightless birds.

Parasitology

The song does not remain the same

Mar 19th 2009
From The Economist print edition

Birdsong reveals the past as well as the present

LIKE many people, birds sing to show off. Singing demands neurological sophistication and physical stamina and is thus a good signal of what fine mates (and bad opponents) they would make.

A recent paper in *Behavioral Ecology*, though, goes one step further. It suggests that singing not only demonstrates how healthy a bird is, but how healthy it was. In avians, as in humans, the effects of childhood ailments can linger into adult life. And that shows up in their song.

The paper's authors, Linda Bischoff of the University of Bern in Switzerland and her colleagues, looked at great tits nesting in boxes in a Swiss forest. As the birds' eggs started to hatch, they removed both the nestlings and the nests from the boxes. They microwaved the nests to kill any parasites and then returned both nests and nestlings. Then they infested half the nests with 60 hen fleas each.

Despite their name, hen fleas are happy to suck blood from other birds. But they do not (as, for example, lice do) live on their hosts continually. Once a bird fledges, therefore, it leaves its parasites behind.

Altogether, Dr Bischoff and her colleagues studied 22 males over the course of six years. Thirteen of these birds came from infested nests and 9 from nests that were free of parasites. They tracked these males, recorded their songs and monitored their behaviour.

Their first observation was that the songs of those males that had suffered fleas in early life were a third shorter than those sung by the others. The once-infested were also less quick off the mark when the time came to sing. Male great tits respond to the calls of other males by calling back rapidly, and thus overlapping the incoming call with their own. By playing recordings of calls to the males they were monitoring, the team found that those which had been flea-free managed to overlap with almost two-thirds of the outsider's call, whereas the others managed to cover less than half of it.

These discoveries complement those of Karen Spencer at Bristol University. Her work revealed that males who did not get enough food as nestlings have a smaller range of songs. They do not, though, sing less or fail to react rapidly to encroaching opponents. That suggests hunger and parasites affect song in different ways—a fact that tits are, no doubt, acutely aware of when they size each other up.

Religion, medicine and death

But not yet, Lord

Mar 19th 2009 | NEW YORK
From The Economist print edition

Religious people seem curiously reluctant to meet their maker

HOW do a person's religious beliefs influence his attitude to terminal illness? The answer is surprising. You might expect the religious to accept death as God's will and, while not hurrying towards it, not to seek to prolong their lives using heroic and often traumatic medical procedures. Atheists, by contrast, have nothing to look forward to after death, so they might be expected to cling to life.

In fact, it is the other way round—at least according to a study published in the *Journal of the American Medical Association* by Andrea Phelps and her colleagues at the Dana-Farber Cancer Institute in Boston. Religious people seem to use their faith to cope with the pain and degradation that "aggressive" medical treatment entails, even though such treatment rarely makes much odds.

Dr Phelps and her team followed the last months of 345 cancer patients. The participants were not asked directly how religious they were but, rather, about how they used any religious belief they had to cope with difficult situations by, for example, "seeking God's love and care". The score from this questionnaire was compared with their requests for such things as the use of mechanical ventilation to keep them alive and resuscitation to bring them back from the dead.

The correlation was strong. More than 11% of those with the highest scores underwent mechanical ventilation; less than 4% of those with the lowest did so. For resuscitation the figures were 7% and 2%.

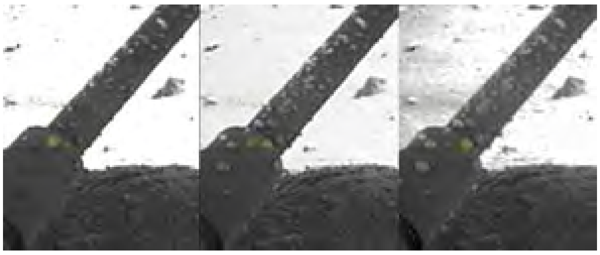
Explaining the unpleasantness and futility of the procedures does not seem to make much difference, either. Holly Prigerson, one of Dr Phelps's co-authors, was involved in another study at Dana-Farber which was published earlier this month in the *Archives of Internal Medicine*. This showed that when doctors had frank conversations about the end of life with terminally ill cancer patients, the patients typically chose not to request very intensive medical interventions.

According to Dr Prigerson, though, such end-of-life chats had little impact on "religious copers", most of whom still wanted doctors to make every effort to keep them alive. Saint Augustine of Hippo, one of Christianity's most revered figures, famously asked God to help him achieve "chastity and continence, but not yet". When it comes to meeting their maker, many religious people seem to have a similar attitude.

Water on Mars

Mar 18th 2009
From The Economist print edition

University of Michigan



These grainy photographs may be the first evidence that liquid water can exist on Mars. They show one of the legs of an American craft called *Mars Phoenix Lander* which touched down near the planet's north pole on May 25th 2008 and operated until it was disabled by the gathering winter in November. According to Nilton Renno, one of the mission's chief scientists, the blotches on the leg are probably drops of brine. The ground on which *Phoenix* landed is icy, and is also rich in salts called perchlorates. Dr Renno thinks that when the craft settled, its thrusters melted some of the ice and the resulting mud splashed onto the leg. The perchlorates in the mud then sucked moisture out of the air until there was enough water for them to dissolve (a process known as deliquescence). Even though the air temperature was around -60°C, the presence of the salts kept the brine liquid, allowing the drops to move around and even, in the case of those highlighted in green, to merge. The reason for the excitement is that, although the existence of ice on Mars has been known since 1666, when the planet's polar caps were first seen, the low temperatures and air pressure there mean that water, even if heavily salted, is likely either to freeze or to evaporate. If it can remain liquid on the leg of a lander, perhaps it can do so elsewhere and thus (hope springs eternal) support life.

Handel's anniversary

Georgian splendour

Mar 19th 2009
From The Economist print edition

As spring begins, the 250th anniversary of Handel's death is being honoured with a glorious splurge of his music

Teatro alla Scala

HIS father, a well-connected doctor in the east German town of Halle, had wanted young Georg Friedrich to become a lawyer. But when the Duke of Saxe-Weissenfels chanced to hear the ten-year-old playing the organ, he was so impressed that he persuaded Mr Händel to allow the boy to train as a musician. By the time the organ-player died in London on April 14th 1759, aged 74, he had become "the great and good Mr Handel". Since then, Handel has enjoyed 250 years of uninterrupted posthumous fame.

To mark the anniversary of his death, the musical world has been getting the bouquets ready. Britain's BBC is planning to broadcast all 42 of his operas during this year. The seven-week London Handel Festival is already in full swing, and festivals in Halle and Göttingen will follow in April and May. A season of the composer's opera "Alcina" (pictured above) has just begun at La Scala in Milan. The Handel House Museum in London's Brook Street, where he lived for the last 36 years of his life, is putting on an exhibition about him next month. Another exhibition, "Handel the Philanthropist", is already running at London's Foundling Hospital, one of Handel's favourite charities. Even the Bank of England, where the great man kept his money, is planning a new display about his financial affairs.

What is it about Handel that has made him so enduring? Some of his hits are played so frequently that even the tone-deaf would recognise them: "Messiah", the "Water Music", the "Music for the Royal Fireworks" and a handful of others. But there is a vast oeuvre, from chamber music to *concerti grossi*, that gets far fewer airings. And many of the operas and oratorios on which his reputation was built during his lifetime have only recently been dusted down again.

For all the reverence in which he is held now, Handel was a musical entrepreneur with a strong commercial orientation. He wrote fast and prolifically. A recent critic called him "the Andrew Lloyd Webber of his day". He also had a habit of reworking musical material, both his own and other people's, that some people found hard to stomach, though at the time it was common practice among musicians.

Having spent time in Italy and learnt how to write Italian operas, he accepted a post as Kapellmeister to the elector of Hanover when he was 25, but was soon off moonlighting in London, putting on Italian operas for a receptive audience. Eventually he got the sack from his post in Hanover for being away so much, but by then he was firmly established in London, receiving a royal pension from the ailing Queen

Anne. A few years later he found himself working for his old boss again when the elector of Hanover became King George I.

By 1727 Handel was so well entrenched in London that, as George Frideric Handel, he became a naturalised British citizen (which required an act of Parliament). The British public took him to its heart and he was well in with the court. Later that year he wrote four anthems for the coronation of King George II, including "Zadok the Priest", which has formed part of every British coronation since.

He had been pouring out the operas, assembling stellar casts of singers from all over Europe and laying on sumptuous productions, but as time went by the expense of mounting full-blown operas and the public's waning appetite for the Italian variety pitched him into financial crisis. His solution was to turn increasingly to oratorios: musical dramas mostly based on a biblical text, unstaged and, crucially, sung in English. They were much cheaper to put on than operas; they could be performed during Lent, when operas were forbidden; and the audiences mostly lapped them up. Although not all of them were successful, they made him not only famous but wealthy too. He left nearly £20,000 in his will, worth almost $4m in today's money.

For all his fame, Handel the man remains an enigma. He never married but had lots of friends, many in high places, and could be good company, though with a stormy temper. He cracked jokes in four or five languages yet retained his thick German accent to the end. His one vice was a huge appetite for food and drink which in time produced a waistline to match.

By the time he died, blind and afflicted by various ailments, he had become so much of a national institution that his wish to be buried in Westminster Abbey was instantly granted, with a large marble statue topping his grave. A year after his death he was honoured with the first full-blown biography of a composer, by John Mainwaring. The tributes just kept coming. Mozart, Haydn and Gluck were strong admirers and Beethoven described him as "the greatest composer that ever lived".

The celebrations of the centenary of Handel's birth set a pattern for the next 150 years that did his music no favours. Bigger was judged to be better, with enormous orchestras and choirs being assembled for a blockbuster series of concerts. The Victorians went even further over the top. Handel-worship reached a climax in a series of festivals at London's Crystal Palace in the late 19th century. A "Messiah" in 1883 featured 4,500 singers and, no doubt, a soupy sound that Handel had never intended.

But despite all this adulation for Handel's music, the operas remained untouched for 180 years after his death. The convoluted plots and the conventions of the *opera seria* style, with their long *da capo* (repeat) arias, were thought to make them unperformable. When at long last some of them were revived in the 1920s, they were severely cut down and many of the lead parts, written for the star castrati of Handel's day, were transposed an octave down for a tenor or a baritone, leaving them barely recognisable.

Happily, the past few decades have brought a complete turnaround in the appreciation of the operas, many of which have entered the mainstream repertoire. Laurence Cummings, the musical director of the London Handel Festival, suggests multiple causes: more research into period performance that has led to more historically informed playing with smaller musical forces and a clearer, purer sound; the rise of the countertenor, the modern equivalent of the castrato without the unacceptable job requirements; even the growth of the recording industry, always on the lookout for new gems.

Modern audiences may have rediscovered in Handel what Sir John Hawkins, a contemporary, described as "that dignity and grandeur of sentiment which music is capable of conveying". For now, they are proving Hawkins right in his prediction that Handel's work will "continue to engage the admiration of judicious hearers as long as the love of harmony shall exist."

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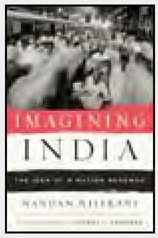
The future of India

The Bangalore enlightenment

Mar 19th 2009
From The Economist print edition

NANDAN NILEKANI, the co-founder of Infosys, one of India's biggest IT firms, is a corporate icon in his homeland. But to many readers outside the country he is best known for a stray comment he made to Thomas Friedman of the *New York Times* in February 2004. His remark ("Tom, the playing field is being levelled") inspired the title and thesis of Mr Friedman's "The World is Flat", a big-think book about offshoring and globalisation that sold millions. The publishers of "Imagining India", Mr Nilekani's admirable first book, must hope that many of those readers will be eager to hear the Indian side of the story, straight from the source.

Imagining India: The Idea of a Renewed Nation
By Nandan Nilekani



Penguin Press; 528 pages; $29.95. To be published in Britain by Allen Lane in April

Buy it at
Amazon.com
Amazon.co.uk

Not to disappoint them, Mr Nilekani provides a chapter on globalisation and two on information technology. But "Imagining India" is a very different book from Mr Friedman's bestseller. Mr Nilekani, an intellectual trapped in an entrepreneur's body, seeks to understand India through the "ebb and flow of its ideas" and debates. Some of these arguments are now resolved, even forgotten. Others have yet to be joined. A third category of ideas commands assent, but no action. And some arguments still burn white-hot.

Of the book's four parts, the best are the first and last. It begins with ideas that were once bitterly resisted, but have since carried the day. It is easy to forget that many Indians once viewed computers as "man-eating machines", entrepreneurs as predators and the English language as a cause of "brain fag". The country that feared a "population bomb" now celebrates its "demographic dividend". These ideas took a circuitous route into favour. English, for example, was retained as a language of government and education, not because of its literary charms or commercial appeal, but because the southern states and the downtrodden castes hated Hindi more.

In the book's final part, Mr Nilekani turns to issues that are not yet on people's minds, but should be. These include the side-effects of development, such as the diseases of affluence (Indians will account for 60% of the world's deaths from heart disease by 2010, according to some projections) and environmental degradation. As a late bloomer, Mr Nilekani argues, India can avoid mistakes made by early industrialisers, such as an overdependence on fossil fuels and unsustainable pension policies. But he fears that India's politicians will not act until they have to. As P.V. Narasimha Rao, the prime minister who presided over India's 1991 crisis, put it, "Decisions are easy when no options are left."

Like Mr Friedman, the author has talked to everybody. But he (and his research assistant, Devi Yesodharan) also appear to have read everything. He begins each chapter with a beautifully curated history of the idea he is exploring. He unearths such gems as Indira Gandhi's aside to a visiting writer, while she waved to an adulatory crowd: "Do get me some more of those cashew nuts. You have no idea how tiring it is to be a goddess." Or the doctor whose 350,000 sterilisations made it into the Guinness book of records. It is hard not to be impressed by an author who alludes to Milton on one page, then turns to the charms of the National Municipal Accounting Manual on another.

Amid these diverting illustrations and examples, the reader can lose track of the book's argument. Mr Nilekani perhaps puts more faith in the power of ideas than seems warranted, even by the evidence he himself presents. He laments that India's politics give an equal hearing to "provably good" policies and "provably bad" ones, such as onerous labour laws, free electricity for farmers and caste quotas.

His opening chapters show that circumstances often change before minds do: workers embraced technology only after their economic advantages became clear. And the second part of the book is devoted to India's speciality: ideas that have prevailed in theory, but not in practice, leaving reformers with nothing more to say, but plenty still to do. Few now doubt the importance of India's schools, its infrastructure, its cities and its internal market. But on these issues, the government remains like "a

walrus moving from side to side", as one of the author's interlocutors puts it.

Reform is sometimes possible without clamour and controversy. Mr Nilekani tells the story of the triumphant effort to digitise Karnataka's village land records. Once established, the computerised registry was instructed to handle orders on a first-in, first-out basis. This meant that corrupt accountants could no longer delay titleholders who refused to pay a bribe. The ploy succeeded, because none of the accountants appreciated its significance until it was too late. It was an example of reform by stealth, accomplished by enterprising technocrats over the heads of interested parties who did not understand it.

Mr Nilekani, however, argues that India has reached the limits of such subterranean reform. The Karnataka experiment, he points out, has had mixed results elsewhere in India, perhaps because accountants will not be fooled twice. Other good ideas die when their champions lose office or move on. Only by winning the argument in open debate, "weaving a safety net of ideas", can champions of reform ensure their ideas prevail with or without them.

Mr Nilekani is doing his bit to weave this safety net. With the historian Ramachandra Guha, he is a trustee of the New India Foundation, which sponsors lectures, fellowships and books from its base in Bengaluru, formerly known as Bangalore. A promising alliance between an industrious scholar and a scholarly industrialist, the foundation brings to mind the Lunar Society of Georgian Birmingham, which counted among its members James Watt, perfecter of the steam engine, and Erasmus Darwin, grandfather of Charles.

Perhaps Bengaluru, which is a comfortable distance from the political gamesmanship of Delhi, the cobwebbed communism of Kolkata and the unabashed money-making of Mumbai, might emerge as an intellectual hub as well as an IT capital. India needs a place where business, politics and ideas can mix without one dominating the others. Mr Nilekani's volume would provide a useful text for such a new lunar society. There are shorter, gentler introductions to India. But this is the second book everyone should read about this compelling country.

Imagining India: The Idea of a Renewed Nation.
By Nandan Nilekani.
Penguin Press; 528 pages; $29.95. To be published in Britain by Allen Lane in Apr

American economic intervention

Cavalry to the rescue

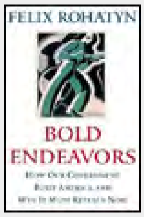
Mar 19th 2009
From The Economist print edition

IN THEIR collective mythology, Americans owe their wealth to an entrepreneurial spirit which government has usually only served to suppress. More so than any other society, Americans give private enterprise the benefit of the doubt. Even now, though outraged at the excesses that led to the current financial crisis, they are deeply cynical about the spending, bailouts and interventions that form the government's response.

Yet the mythology is based on a selective interpretation of history. Felix Rohatyn demonstrates this by recounting ten episodes of significant and ultimately beneficial economic initiatives taken by past American governments.

Mr Rohatyn, now aged 80, is best known as the former investment banker who helped rescue New York City from bankruptcy in the 1970s. This is his first book written for a popular audience and it is an engaging and easy read. It has no footnotes and relies mostly on secondary sources. Mr Rohatyn does not explicitly draw parallels between his episodes and the present but they are inescapable. Like the current $700 billion Troubled Asset Relief Programme, Herbert Hoover's Reconstruction Finance Corporation (RFC) aimed to stabilise the banking system by injecting capital into banks. Conservatives attacked it as "the beginning of state socialism" while voters were outraged that it "willingly lent bankers fantastic sums while millions of unemployed Americans starved." Hoover's own ambivalence about its role restrained the RFC's potential until the Depression was much deeper and Franklin Roosevelt was president.

Bold Endeavors: How Our Government Built America, and Why It Must Rebuild Now
By Felix Rohatyn



Simon & Schuster; 259 pages; $26

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Private investors are much better than the government at sniffing out high returns, but they often failed to finance what turned out to be immensely profitable projects. Burnt in early canal investments, they refused to back the Erie Canal to connect the Great Lakes to New York City; the job fell to the state of New York. Similarly, federal construction of the Panama Canal began where a failed private French consortium left off. Private utilities were hostile to Roosevelt's proposal to extend electricity to rural America. It was eventually accomplished by farmers' co-operatives, municipalities and public utilities backed by federal loans whose default rate was less than 1%.

Like Barack Obama, Mr Rohatyn is an unabashed advocate of more public infrastructure spending and has proposed a National Infrastructure Bank to finance it. Not surprisingly, he does not discuss the many disasters that dot the history of public intervention (the Army Corps of Engineers and flood control come to mind). Still, he does not gloss over the seamy side of his episodes. Self-dealing and corruption were rife among the companies entrusted by the federal government to build the transcontinental railway. The presidents who willed many of these projects into existence were often cavalier about their legality. Thomas Jefferson went ahead with the Louisiana Purchase even though he was not sure the constitution permitted it. Theodore Roosevelt fomented Panama's secession from Colombia when the latter refused to let him build his canal.

Many of these projects were driven by their backers' experiences. Dwight Eisenhower's support for the Interstate highway system was rooted in a disastrous transcontinental convoy that bogged down on dilapidated roads early in his army career. It turns out that Mr Rohatyn's advocacy also has personal roots. His family were refugees from Hitler. Yet in 1946 he was nearly forced to leave his college fraternity for being Jewish. Two army veterans kicked out the fraternity representatives with the admonition that they had not fought the Nazis to see racial laws enacted at home. Like millions of veterans, the two went to college under the GI Bill, the subject of one of Mr Rohatyn's chapters.

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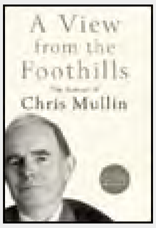
By Felix Rohatyn.
Simon & Schuster; 259 pages; $26

A British minister's diaries

Reflections of a bit-part player

Mar 19th 2009
From The Economist print edition

A View from the Foothills: The Diaries of Chris Mullin
Edited by Ruth Winstone



Profile Books; 590 pages; £20

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THE best political diaries, by and large, are written by those who were close enough to the action to have insights denied to the outside observer, but not so near the centre that every entry is written with an eye on posterity. It is partly because of this that the diary kept by Chris Mullin between 1999 and 2005 is by far the most revealing and entertaining to have emerged from the now-dying era of New Labour. But it is also because Mr Mullin is such an agreeably modest and philosophical companion, albeit one still capable of throwing many a well-aimed barb.

The diaries begin with Mr Mullin, once a fiery left-wing MP but by then the respectable chairman of a home-affairs committee, agonising over whether to accept an offer to become the lowest form of ministerial life in the sprawling empire (covering transport, the environment and the regions) of John Prescott, the deputy prime minister. With a plea to Tony Blair (referred to throughout as “The Man”) not to forget about him, he decides to take the plunge. Needless to say, the prime minister forgets that conversation and Mr Mullin disappears “under a mountain of tedium”, applying himself not very successfully to the tasks that those higher up the greasy pole disdain as too dull or disagreeable.

Among them is defending the government’s plan to part-privatise air-traffic control. Mr Mullin has no personal ideological objection, but the policy is loathed by most Labour MPs and has few supporters even within government. When he suggests that it seems to be going to a lot of political trouble for a measly amount of money, he is told that Gordon is adamant. Mr Brown (then chancellor of the exchequer) never bothers to tell Mr Mullin why and remains throughout the diaries in the background as a sinister, controlling presence.

Mr Mullin reserves his real passion and energy for fighting the government car-pool service, which is determined to punish him for refusing a chauffeur-driven vehicle, and the High Hedges Bill, a noble bid to control the spread of fast-growing leylandii. With pluck and cunning he outwits the man from the car pool, but tastes defeat over the leylandii when Mr Blair’s office decides that Middle England will brook no interference with its gardens.

Although Mr Mullin convinces himself that his boss, Mr Prescott, for all his fragile vanity, is a decent man, the picture he paints of “Prezza’s” self-indulgence, intellectual indiscipline and micromanaging incompetence is even more appalling than was hitherto supposed. Mr Mullin reflects that ministerial team meetings with Mr Prescott must be rather like being at the court of Boris Yeltsin.

After 18 months comes a welcome transfer to Clare Short’s fast-growing international-development department. But from the outset it is apparent that there is no real job for Mr Mullin when Ms Short cheerfully informs him that he can be involved in anything that interests him, but that all the decisions will be hers.

Sensibly, after a decent interval, Mr Mullin returns to the backbenches and his chairmanship of the home-affairs committee. Immediately he has real influence again, producing useful reports and seeing “The Man” almost every week. He is increasingly troubled by the growing clamour about “bogus asylum-seekers”, an issue repeatedly raised with him by his working-class constituents in Sunderland. He sees the arguments in shades of grey: many of the asylum-seekers are indeed fraudulent, but the way in which the authorities deal with them is both spectacularly inefficient and inhumane.

From the backbenches, he also has a far better vantage point from which to observe the slow but unstoppable drift into war with Iraq. Mr Mullin sympathises with Mr Blair for his predicament but, after

soul-searching and a few wobbles, he votes against the war. He is both suspicious of American motives and fearful of the way in which the military campaign will be conducted. Above all, he thinks that in George Bush, Dick Cheney and Donald Rumsfeld, Mr Blair has become hostage to some very bad men.

In spite of his rebellion, Mr Blair gives Mr Mullin a third crack at government, this time as the Foreign Office's Africa hand, a job he genuinely loves and seems to be quite good at. But after the 2005 election, he is capriciously fired by Mr Blair on the ground that room must be found for new faces. Mr Mullin tells Mr Blair he is devastated and there the diary ends. But it is not in Mr Mullin's unpompous nature to remain angry and disappointed for long. He now has the satisfaction of having written a diary that tells us almost as much about British politics as that great television series, "Yes Minister".

A View from the Foothills: The Diaries of Chris Mullin.
Edited by Ruth Winstone.
Profile Books; 590 pages; £20

Constable's early life

Finding nothing ugly

Mar 19th 2009
From The Economist print edition

Constable in Love: Love, Landscape, Money and the Making of a Great Painter
By Martin Gayford

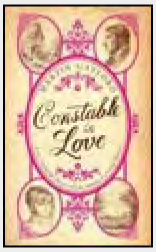

Fig Tree; 384 pages; £20

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IN AN afterword Martin Gayford says that he would like his book about the painter, John Constable, to give the same pleasure that a novel would. He succeeds wonderfully. Not in the sense of invented dialogue or fictional scenes. There is no need. His characters all wrote letters or diaries full of colour and circumstance. Their background would be familiar to readers of Jane Austen, a writer Mr Gayford often and aptly refers to: a few families thrown together by class, alive to every social nuance, ears pricked for money and rank. It was a world of wills and bequests, where young lovers lived on dreams until old curmudgeons fell off their perches.

Such was the fate of Constable—handsome, possessed of a mind, as he said, "of the most excruciating sensibility"—and pretty Maria Bicknell, who waited seven years before they could marry in 1816. Her father was a London solicitor; his a prosperous corn merchant in the Suffolk village of East Bergholt, where Maria's rich grandfather was rector. All of them took a dim view of painting as a profession.

Constable found little encouragement from his fellows either. Landscape painting ranked low in the hierarchy of genres, especially Constable's kind: fields, mills, towpaths—mere "map-work", scoffed J.H. Fuseli, professor at the Royal Academy. Besides, many thought Constable's execution crude. His loose, free brushwork impressed the French, notably Eugène Delacroix, but the English wanted more finish. Maria, who bore him seven children, died of tuberculosis before he was elected to the Royal Academy in 1829.

That's the bare outline, but Mr Gayford fills it with characters and detail, tracing connections and opening perspectives at every level. He moves easily between painting and music and social history, between pastoral poetry and agricultural unrest. Quoting from contemporaries, he conjures up the London of the day, the customs of the countryside. Above all, he brings home the intellectual debates of the time, on Art and Nature, the Sublime and the Beautiful. These things arise not by way of context, but directly and intimately from the lives of his protagonists.

Constable was extraordinarily modern in believing that nothing could be intrinsically ugly: "old rotten planks, slimy posts, and brickwork, I love such things," he wrote. It was a question of association and feeling. Mood mattered more than subject matter. He once corrected someone who had called a painting of his "only a picture of a house", by pointing out that it was a picture "of a summer's morning, including a house".

He liked to think of the landscape as a friend, even as his mistress. But he was not a jealous lover. Maria must join in. Writing to her one summer about painting the landscape at East Bergholt, he exclaimed: "Either I am improved…or Nature has unveiled her beauties to me with a less fastidious hand…what would be my happiness could I have this enjoyment with you." Maria's reply is not recorded.

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By Martin Gayford.
Fig Tree; 384 pages; £20

Ali Bongo

Mar 19th 2009
From The Economist print edition

Ali Bongo (William Oliver Wallace), master magician, died on March 8th, aged 79

Ann Pownall

CALL Ali Bongo! Strike up "In a Persian Market"! On he capers, knock-kneed, curly-shoed, spindly-legged in awful black tights, like something out of the *Beano*! A big feather bobbing in his turban-fez, huge glasses askew, and his false moustaches flying! A yellow tube under his arm; waves the wand, sprinkles the dust, pulls out pink flowers, blue flowers, green flowers, till the tree is ten feet tall! Takes a sparkling hoop; blows on it, waves it, it turns into a square! Hides a bottle under a cylinder; can't get it to disappear; tries a new wand, sprinkles the dust, dances about; seizes the cylinder, sticks his arm right through, pulls out a string of flags, a bunch of flowers, a live white wriggling rabbit, a pair of knickerbockers, the bottle! Bows to rapturous applause!

His other side was rather quiet. But it was no less magical, and more himself. He would be "Alastair", a conjuror's assistant, still with the spectacles (a solitary dash of unruliness) but in a neat grey suit. Standing silently but amiably to one side, he would unbolt the magic boxes, hold the ropes, demonstrate the emptiness of beakers and pots, confirm the thickness of a sheet of glass before a near-naked girl would climb into a magic box and pass straight through it! Audience in tumults of delight! Or he would be under the cloth-draped table, "setting things and loading things", as he would cryptically say in his soft, quick, unassuming way, while David Nixon and Paul Daniels, the magicians par excellence of 1960s and 1970s British TV shows, shuffled cards, read minds and juggled with doves, baffling folk with their illusions.

He invented many of their tricks himself, up all night sometimes in his Clapham flat, keeping himself going with spoonfuls of "Pongolian hotpot", based on tinned stewing steak and baked beans. And he built most of the props himself, which was why, in his patient sidekick's role, he would often give them a proprietary pat to make sure their magic worked. Some would disappear in ever-increasing circles of glitter and silk handkerchiefs (Hocus pocus, fishbones chokus!); some were only ever rubber bands and cardboard; but many were built to last, cluttering his flat to the point where he had to buy the flat below in order to have a hole to sleep in.

With a craftsman's rigour, he lamented that you couldn't get proper, thick, brown rope these days, or red-tipped matches that exploded. His first memory of magic, from the age of three, was hammering a nail into hidden matches at a show in the garrison at Secunderabad, in south-east India, where his father was stationed. He crept across the stage; he raised the hammer; missed once; missed twice; then a

huge bang! Soldiers fell dead! Blackout! Laughter and cheers!

The magician's code of secrecy was something he took most seriously, long before he became vice-president and eventually president of the Magic Circle. Nothing must be divulged in public about how a trick worked. This would spoil everything for children, his favourite audience, who would have no tricks to show their friends. The books he wrote about his art were, he said, a different matter; the reader had to make an effort to find out the information. Ever fizzing on the subject, delighting in magicians' conventions where tips and tricks were busily exchanged in corners, he dropped occasional hints about "metal gimmicks" in the rope trick and "tin tubes" that could make a coin disappear into a metal box inside another metal box inside an immense ball of twine—but listeners were none the wiser. He stressed that wide and deep study of chemistry, electricity, lighting and mechanics was needed to create illusions. But as he talked, you couldn't help noticing his hands: the long, thin fingers fluttering, locking, unlocking, gesticulating, as if he could flip cards and slip knots in his sleep.

The vanishing band

His first trick was learned, at five, from a column in the *Times of India*. Pinch up a fold of skin, make a matchbox stick on your hand! Terrify your mother! But the best he ever saw, one he never quite succeeded in replicating, was done by an Indian street magician who, for a few annas, came to perform in his school. The man took a tall glass goblet with a metal base, filled it with ink-black nasty liquid, got his assistant to stir it up, threw it at the teacher! And as he did it vanished, and turned into fresh flowers with dew on them! From then on, magic had to be young William's life. He started a magic club at school, put on shows, demonstrated tricks at Hamley's toyshop in London, put his name to a hat that grew bigger and changed colour with each wave of a wand (red! blue! green! stripes!), and gave advice to every TV producer who needed magic in his plots. He could produce almost any illusion, though he was not saying how.

He had a dream of a biggest-and-best trick, but it was nothing glitzy. No false eyebrows, no curled shoes. He would set up a big hollow tube on a hill; the Dagenham Girl Pipers (or similar) would march into it; two men, one at each end, would gradually compress the tunnel; it would get smaller and smaller, the music less and less; and then it would collapse! Crumple up, and roll right down the hill! A helicopter, panning away, would show the whole landscape empty, not a band in sight! And no magician, either.

Overview

Mar 19th 2009
From The Economist print edition

There was more gloomy news on **industrial production**: in the year to the fourth quarter it fell by 10.3% in Hong Kong; in the year to January it was down by 19.2% in Germany, 16.7% in Italy and 11.1% in Mexico; and in the year to February it dropped by 11.2% in America and 13.2% in Russia.

The **Federal Reserve** said it would buy up to $300 billion of longer-dated government bonds to help spur economic recovery. The yield on ten-year Treasuries soon dropped to 2.5%, having been above 3% a day earlier. The Fed also said it would expand its purchases of mortgage-related debt.

Consumer prices in **America** rose by 0.5% in February. The annual inflation rate ticked up from zero to 0.2%. The core measure, which excludes food and energy, went up by 0.2% to be 1.8% higher than a year earlier.

There were, however, signs that America's **construction** bust has bottomed out. New housing starts jumped by 22.2% in February. The number of permits to build new private homes also rose.

America's **current-account deficit** narrowed to $132.8 billion (3.7% of GDP) in the fourth quarter, helped by cheaper oil imports.

Britain's unemployment rate rose to 6.5% in the three months to January, up from 6% in the previous three months. The number of claims for unemployment benefits, a timelier measure of shifts in the job market, rose by 138,400 in February, the biggest monthly climb since records began in 1971.

Output, prices and jobs

Mar 19th 2009
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product latest	Gross domestic product qtr*	Gross domestic product 2009†	Gross domestic product 2010†	Industrial production latest	Consumer prices latest	Consumer prices year ago	Consumer prices 2009†	Unemployment rate‡, %
United States	-0.8 Q4	-6.2	-2.2	+1.9	-11.2 Feb	+0.2 Feb	+4.0	-0.6	8.1 Feb
Japan	-4.3 Q4	-12.1	-5.3	+0.5	-30.8 Jan	nil Jan	+0.7	-0.8	4.1 Jan
China	+6.8 Q4	na	+6.0	+7.0	+3.8 Jan-Feb	-1.6 Feb	+8.7	-0.2	9.0 2008
Britain	-1.9 Q4	-6.0	-3.1	+0.5	-11.4 Jan	+3.0 Jan§	+2.2	+1.0	6.5 Jan††
Canada	-0.7 Q4	-3.4	-1.5	+1.7	-5.7 Dec	+1.1 Jan	+2.2	+0.5	7.7 Feb
Euro area	-1.3 Q4	-5.8	-2.4	+0.7	-12.0 Dec	+1.2 Feb	+3.3	+0.6	8.2 Jan
Austria	+0.5 Q4	-0.8	-1.3	+0.8	-4.7 Dec	+1.2 Jan	+3.2	+0.8	4.0 Jan
Belgium	-0.8 Q4	-6.5	-1.8	+0.9	-6.5 Dec	+1.9 Feb	+3.6	+1.1	11.2 Feb‡‡
France	-1.0 Q4	-4.6	-1.9	+0.7	-13.8 Jan	+0.9 Feb	+2.8	+0.4	8.3 Jan
Germany	-1.7 Q4	-8.2	-3.2	+0.8	-19.2 Jan	+1.0 Feb	+2.8	+0.4	7.9 Feb
Greece	+2.4 Q4	+1.2	-1.9	-0.3	-8.7 Dec	+1.6 Feb	+4.4	+0.9	7.8 Nov
Italy	-2.9 Q4	-7.5	-2.7	+0.5	-16.7 Jan	+1.6 Feb	+2.9	+1.0	6.7 Q3
Netherlands	-0.6 Q4	-3.4	-1.9	+0.8	-13.3 Dec	+2.0 Feb	+2.2	+0.7	4.1 Feb††
Spain	-0.7 Q4	-3.8	-2.5	nil	-23.6 Jan	+0.7 Feb	+4.4	+0.6	14.8 Jan
Czech Republic	+0.7 Q4	-3.7	-2.0	+1.6	-14.6 Dec	+2.0 Feb	+7.5	+1.8	7.4 Feb
Denmark	-3.9 Q4	-7.8	-2.2	+0.7	-9.2 Jan†††	+1.9 Feb	+3.1	+1.2	2.3 Jan
Hungary	+2.0 Q4	-3.9	-3.0	+0.4	-21.0 Jan	+3.0 Feb	+6.9	+2.9	8.4 Jan††
Norway	+0.8 Q4	+5.6	-1.2	+0.5	-0.6 Jan	+2.5 Feb	+3.7	+1.7	3.0 Dec***
Poland	+2.9 Q4	na	+0.7	+2.2	-14.9 Jan	+3.3 Feb	+4.2	+3.0	10.5 Jan‡‡
Russia	+1.1 Q4	na	-2.0	+3.0	-13.2 Feb	+12.0 Feb	+12.7	+13.0	8.1 Jan‡‡
Sweden	-4.9 Q4	-9.3	-2.2	+0.9	-22.9 Jan	+0.9 Feb	+3.1	-0.1	8.0 Feb‡‡
Switzerland	-0.1 Q4	-1.2	-1.6	+0.7	-6.0 Q4	+0.2 Feb	+2.4	-0.1	3.1 Feb
Turkey	+0.5 Q3	na	-2.0	+1.5	-21.3 Jan	+7.7 Feb	+9.1	+7.8	12.3 Q4‡‡
Australia	+0.3 Q4	-2.1	-0.3	+1.6	+3.8 Q3	+3.7 Q4	+3.0	+2.1	5.2 Feb
Hong Kong	-2.5 Q4	-7.8	-5.9	-0.2	-10.3 Q4	+3.1 Jan	+3.3	+1.1	5.0 Feb††
India	+5.3 Q4	na	+5.0	+6.4	-0.5 Jan	+10.4 Jan	+5.5	+5.4	6.8 2008
Indonesia	+5.2 Q4	na	+1.9	+2.2	-2.8 Dec	+6.9 Feb	+7.4	+5.5	8.4 Aug
Malaysia	+0.1 Q4	na	-0.3	+2.8	-20.2 Jan†††	+3.9 Jan	+2.3	+1.1	3.1 Q3
Pakistan	+5.8 2008**	na	+1.2	+3.2	-1.6 Dec	+21.1 Feb	+11.3	+10.1	5.6 2007
Singapore	-4.2 Q4	-16.4	-7.5	+1.9	-29.1 Jan	+2.9 Jan	+6.6	+0.9	2.6 Q4
South Korea	-3.4 Q4	-20.8	-5.9	+0.3	-25.6 Jan	+4.1 Feb	+3.6	-0.6	3.5 Feb
Taiwan	-8.4 Q4	na	-6.5	+0.1	-43.1 Jan	-1.3 Feb	+3.9	-1.0	5.3 Jan
Thailand	-4.3 Q4	-22.2	-4.4	+1.8	-21.3 Jan	-0.1 Feb	+5.4	-1.2	1.4 Dec
Argentina	+4.9 Q4	-1.2	-2.8	+1.5	-4.4 Jan	+6.8 Feb	+8.4	+6.4	7.3 Q4‡‡
Brazil	+1.3 Q4	-13.6	-0.4	+3.2	-17.2 Jan	+5.9 Feb	+4.6	+4.4	8.2 Jan‡‡
Chile	+4.8 Q3	-0.2	+0.4	+2.3	-8.9 Jan	+5.5 Feb	+8.1	+3.7	8.0 Jan††‡‡
Colombia	+3.1 Q3	+2.9	-1.0	+1.5	-9.2 Dec	+6.5 Feb	+6.4	+5.0	14.2 Jan‡‡
Mexico	-1.6 Q4	-10.3	-2.6	+1.4	-11.1 Jan	+6.2 Feb	+3.7	+4.8	5.0 Jan‡‡
Venezuela	+3.2 Q4	na	-3.0	-5.4	+2.4 Nov	+29.5 Feb	+25.4	+31.6	6.3 Q4‡‡
Egypt	+5.9 Q3	na	+3.9	+3.9	+7.3 Q3	+13.5 Feb	+12.1	+7.8	8.6 Q3‡‡
Israel	+1.2 Q4	-0.5	+0.4	+2.6	+1.2 Dec	+3.4 Feb	+3.6	+1.8	6.3 Q4
Saudi Arabia	+3.5 2007	na	+0.4	+3.3	na	+7.9 Jan	+5.8	+4.3	na
South Africa	+1.0 Q4	-1.8	-0.8	+3.1	-11.1 Jan	+8.1 Jan	+9.3	+6.0	21.9 Dec‡‡

*% change on previous quarter, annual rate. †*The Economist* poll or Economist Intelligence Unit estimate/forecast. ‡National definitions.- §RPI inflation rate 0.1% in Jan. **Year ending June. ††Latest three months. ‡‡Not seasonally adjusted. ***Centred 3-month average †††New series

The Economist commodity-price index

Mar 19th 2009
From The Economist print edition

The Economist commodity-price index

2000=100

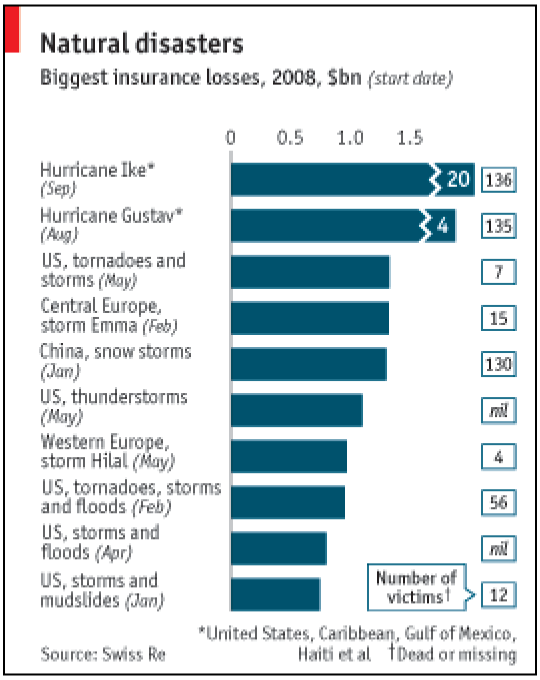
	Mar 10th	Mar 17th*	% change on one month	% change on one year
Dollar index				
All items	153.3	157.7	+1.6	-39.5
Food	178.7	184.4	+0.3	-29.3
Industrials				
All	120.6	123.2	+4.3	-52.6
Nfa†	104.9	107.1	-3.3	-43.9
Metals	129.1	132.0	+8.0	-55.7
Sterling index				
All items	168.0	170.6	+3.3	-12.7
Euro index				
All items	111.2	112.4	-1.5	-26.3
Gold				
$ per oz	894.20	916.80	-5.5	-8.8
West Texas Intermediate				
$ per barrel	45.71	48.97	+40.1	-55.2

*Provisional †Non-food agriculturals.

Natural disasters

Mar 19th 2009
From The Economist print edition

More than 240,000 people lost their lives to natural and man-made catastrophes last year, according to Swiss Re. The insurance firm puts the total cost of damages at $269 billion, less than a fifth of which was covered by insurance. Much of the $52 billion paid out by insurers was accounted for by the devastation caused by Ike and Gustav, two hurricanes that struck the Gulf of Mexico in August and September. Another two of the big insurance losses were for storms in Europe, but these claimed fewer lives than those in America. China's earthquake in May left almost 88,000 people dead or missing. The worst catastrophe was tropical cyclone Nargis in Myanmar, which claimed 140,000 victims.



Trade, exchange rates, budget balances and interest rates

Mar 19th 2009
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance		Currency units, per $		Budget balance % of GDP 2009†	Interest rates, %	
		latest 12 months, $bn	% of GDP 2009†	Mar 18th	year ago		3-month latest	10-year gov't bonds, latest
United States	-797.1 Jan	-673.3 Q4	-3.3	-	-	-13.7	0.37	2.53
Japan	+28.5 Jan	+143.3 Jan	+2.0	98.1	99.3	-5.6	0.56	1.31
China	+311.5 Feb	+400.7 Q2	+6.1	6.83	7.06	-3.6	1.24	3.21
Britain	-167.7 Jan	-45.6 Q3	-2.0	0.72	0.50	-11.3	1.90	3.11
Canada	+41.6 Jan	+11.3 Q4	-1.1	1.27	1.00	-2.4	0.42	2.86
Euro area	-46.4 Dec	-89.6 Dec	-0.8	0.76	0.64	-4.6	1.60	3.22
Austria	-2.4 Dec	+16.8 Q3	+1.6	0.76	0.64	-3.4	1.60	4.29
Belgium	+7.1 Dec	-8.2 Sep	+0.7	0.76	0.64	-3.6	1.62	4.14
France	-80.6 Jan	-56.8 Jan	-2.2	0.76	0.64	-5.4	1.60	3.77
Germany	+250.7 Jan	+224.3 Jan	+5.3	0.76	0.64	-3.9	1.60	3.22
Greece	-65.0 Dec	-51.2 Dec	-12.2	0.76	0.64	-4.8	1.60	5.73
Italy	-18.4 Jan	-72.9 Dec	-2.0	0.76	0.64	-4.3	1.60	4.53
Netherlands	+51.7 Jan	+67.6 Q3	+6.2	0.76	0.64	-1.3	1.60	3.79
Spain	-139.3 Dec	-154.5 Dec	-7.8	0.76	0.64	-7.4	1.60	4.01
Czech Republic	+3.8 Jan	-7.3 Jan	-2.3	20.6	16.3	-3.0	2.50	5.38
Denmark	+5.6 Dec	+6.8 Jan	+1.0	5.68	4.77	-2.0	3.24	3.86
Hungary	-0.4 Jan	-11.3 Q3	-3.7	231	164	-2.7	9.54	11.50
Norway	+73.7 Feb	+83.4 Q4	+10.9	6.73	5.15	10.6	3.27	4.02
Poland	-23.1 Jan	-28.1 Jan	-4.9	3.49	2.26	-2.2	4.27	6.24
Russia	+170.8 Jan	+98.9 Q4	-3.3	34.5	23.6	-6.1	13.00	11.86
Sweden	+15.7 Jan	+40.3 Q4	+6.7	8.38	6.01	-3.3	0.30	2.96
Switzerland	+18.4 Feb	+40.3 Q3	+8.7	1.17	1.00	-1.7	0.41	1.88
Turkey	-65.7 Jan	-37.2 Jan	-3.4	1.72	1.23	-4.2	12.09	8.56‡
Australia	-1.0 Jan	-44.1 Q4	-5.3	1.52	1.09	-3.1	3.04	4.37
Hong Kong	-24.1 Jan	+26.4 Q3	+9.1	7.75	7.77	-4.5	0.92	1.97
India	-111.2 Jan	-28.5 Q3	-3.7	51.3	40.4	-7.2	4.57	7.25
Indonesia	+8.0 Jan	+0.6 Q4	+0.2	11,970	9,185	-2.9	9.38	10.28‡
Malaysia	+42.2 Jan	+38.3 Q3	+7.8	3.68	3.18	-6.6	2.09	3.59‡
Pakistan	-19.7 Feb	-15.6 Q3	-5.8	80.5	62.9	-6.4	12.10	21.98‡
Singapore	+16.1 Jan	+27.1 Q4	+15.4	1.53	1.38	-4.1	0.65	2.10
South Korea	-8.5 Feb	-5.0 Jan	+1.2	1,421	1,009	-3.5	2.42	4.81
Taiwan	+6.3 Feb	+25.0 Q4	+7.9	34.1	30.7	-5.0	0.90	1.34
Thailand	+1.7 Jan	-1.3 Jan	+1.4	35.8	31.2	-4.7	1.82	2.94
Argentina	+12.8 Jan	+9.0 Q3	-0.5	3.65	3.15	-0.8	14.50	na
Brazil	+24.2 Feb	-27.0 Jan	-2.2	2.30	1.70	-1.5	11.16	6.16‡
Chile	+7.6 Feb	-3.4 Q4	-3.4	592	439	-3.5	3.36	3.79‡
Colombia	+2.1 Feb	-5.3 Q3	-4.0	2,389	1,823	-3.3	8.34	7.03‡
Mexico	-16.6 Jan	-2.4 Q4	-3.4	14.1	10.7	-3.2	7.18	8.37
Venezuela	+39.2 Q4	+39.2 Q4	+0.2	6.14	4.20§	-5.2	17.01	6.55‡
Egypt	-25.2 Q3	+0.1 Q3	-1.0	5.63	5.48	-7.1	10.52	4.16‡
Israel	-12.8 Feb	+2.6 Q3	+1.9	4.14	3.38	-5.0	0.55	3.53
Saudi Arabia	+150.8 2007	+95.0 2007	-7.9	3.75	3.75	-8.0	1.15	na
South Africa	-8.7 Jan	-23.2 Q3	-7.0	9.94	8.00	-3.3	9.15	8.22

*Merchandise trade only. †*The Economist* poll or Economist Intelligence Unit forecast. ‡Dollar-denominated bonds. §Unofficial exchange rate.

Markets

Mar 19th 2009
From The Economist print edition

Markets

	Index Mar 18th	% change on one week	% change on Dec 31st 2008 in local currency	% change on Dec 31st 2008 in $ terms
United States (DJIA)	7,486.6	+8.0	-14.7	-14.7
United States (S&P 500)	794.4	+10.1	-12.1	-12.1
United States (NAScomp)	1,491.2	+8.7	-5.4	-5.4
Japan (Nikkei 225)	7,972.2	+8.1	-10.0	-16.9
Japan (Topix)	764.7	+5.9	-11.0	-17.8
China (SSEA)	2,334.2	+4.0	+22.1	+21.9
China (SSEB, $ terms)	145.6	+4.1	+31.5	+31.2
Britain (FTSE 100)	3,805.0	+3.0	-14.2	-16.6
Canada (S&P TSX)	8,629.1	+7.7	-4.0	-6.8
Euro area (FTSE Euro 100)	620.0	+3.9	-16.9	-21.7
Euro area (DJ STOXX 50)	2,019.2	+4.5	-17.5	-22.2
Austria (ATX)	1,557.6	+7.4	-11.0	-16.1
Belgium (Bel 20)	1,698.4	+3.1	-11.0	-16.1
France (CAC 40)	2,760.3	+3.2	-14.2	-19.1
Germany (DAX)*	3,996.3	+2.1	-16.9	-21.6
Greece (Athex Comp)	1,578.6	+2.6	-11.6	-16.7
Italy (S&P/MIB)	14,473.0	+6.7	-25.6	-29.9
Netherlands (AEX)	209.3	-0.5	-14.9	-19.7
Spain (Madrid SE)	806.0	+6.3	-17.4	-22.1
Czech Republic (PX)	706.3	+4.5	-17.7	-23.0
Denmark (OMXCB)	208.2	+1.5	-7.9	-13.3
Hungary (BUX)	9,897.3	+1.7	-19.2	-33.0
Norway (OSEAX)	252.7	-0.6	-6.5	-2.8
Poland (WIG)	22,892.3	-1.5	-15.9	-28.6
Russia (RTS, $ terms)	650.6	+3.7	+16.2	+3.0
Sweden (Aff.Gen)	195.4	+0.2	-0.9	-6.5
Switzerland (SMI)	4,783.3	+4.5	-13.6	-21.2
Turkey (ISE)	23,497.2	+0.9	-12.5	-21.5
Australia (All Ord.)	3,386.2	+5.8	-7.5	-11.0
Hong Kong (Hang Seng)	13,117.2	+9.9	-8.8	-8.9
India (BSE)	8,976.7	+10.0	-7.0	-11.6
Indonesia (JSX)	1,322.8	+0.6	-2.4	-11.1
Malaysia (KLSE)	848.0	-0.3	-3.3	-9.1
Pakistan (KSE)	6,266.0	+12.7	+6.8	+5.1
Singapore (STI)	1,575.9	+4.7	-10.5	-15.6
South Korea (KOSPI)	1,170.0	+3.8	+4.0	-7.8
Taiwan (TWI)	5,047.5	+6.0	+9.9	+5.7
Thailand (SET)	426.2	+2.8	-5.3	-8.1
Argentina (MERV)	1,065.6	+6.1	-1.3	-6.7
Brazil (BVSP)	40,142.0	+3.4	+6.9	+8.2
Chile (IGPA)	11,973.1	+2.4	+5.7	+13.8
Colombia (IGBC)	7,894.4	+2.1	+4.4	-1.7
Mexico (IPC)	19,620.5	+10.3	-12.3	-14.1
Venezuela (IBC)	41,067.2	+9.0	+17.0	+26.0
Egypt (Case 30)	3,914.7	+5.4	-14.8	-16.6
Israel (TA-100)	607.2	+2.9	+7.6	-1.8
Saudi Arabia (Tadawul)	4,400.2	+6.5	-8.4	-8.3
South Africa (JSE AS)	19,355.8	+1.2	-10.0	-16.3
Europe (FTSEurofirst 300)	710.9	+2.6	-14.6	-19.4
World, dev'd (MSCI)	788.8	+7.9	-14.3	-14.3
Emerging markets (MSCI)	543.9	+6.1	-4.1	-4.1
World, all (MSCI)	197.4	+7.7	-13.3	-13.3
World bonds (Citigroup)	763.8	+1.2	-5.7	-5.7
EMBI+ (JPMorgan)	395.0	+2.4	+0.9	+0.9
Hedge funds (HFRX)‡	1,024.7	-0.2	+0.4	+0.4
Volatility, US (VIX)	40.1	43.6	40.0	(levels)
CDSs, Eur (iTRAXX)†	191.1	-0.9	-5.4	-10.8
CDSs, N Am (CDX)†	266.6	-2.7	+14.2	+14.2
Carbon trading (EU ETS) €	12.4	+6.3	-23.1	-27.5

*Total return index. †Credit-default swap spreads, basis points.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CMIE; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡Mar 10th

Office rents

Mar 19th 2009
From The Economist print edition

Office rents in London, measured in dollars, fell by 41% in the year to the fourth quarter of 2008, according to CB Richard Ellis, a property firm. Around half of that drop reflects lower local charges for office space. The rest was down to a fall in sterling against the dollar. Almost all of Sydney's 25% decline in rents was because of a weaker Australian dollar. Rents in other rich cities, such as Frankfurt, New York and Paris, dropped by less. These places are already cheaper than Moscow. The rise in Tokyo rents makes it the most expensive city in the survey. All and more of the rise in charges was because of the yen's appreciation. Rents in Beijing were barely changed in yuan, but cost 8% more than a year earlier in dollars.